

A STUDY ON RISING EFFECTS OF CRYPTOCURRENCY IN THE REGULATIONS OF MALAYSIAN LEGAL SYSTEM

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ABSTRACT

Financial technology or “FinTech” has taken many forms over the years and it has been changing the world as we know of it right now. The very recent take on this would be the introduction of cryptocurrency. The question lies in understanding the very state of this ‘cryptocurrency’ form, as it is a virtual currency that possesses an exchange rate to an existing currency that allows trading to be done over one another or it can be used within a “blockchain” as a form internal collaborative in-house currency for a specific purpose or an organization. However, it is not regulated by one single system and it has own unique features of the decentralised system that determines the creation and maintenance of it. Even though such digital currencies are not recognised as a legal tender by the Malaysian Central Bank – the Bank Negara, speculation risk still arises as such cryptocurrency are pooling a substantially large amount of money from investors around the world and also the risk of money laundering alongside terrorism financial risk. This paper aims to study the steps taken by the relevant authority including the central bank in regulating cryptocurrency in Malaysia. Another point of reference that was covered in this study is comparing and contrasting the regulatory changes in relation to cryptocurrency at a surface level that have been proposed or implemented by a total of eleven nations (Australia, China, Estonia, Gibraltar, Japan, Russia, Singapore, South Korea, Switzerland, United Kingdom and United States). The study concludes by proposing the suggestive regulatory changes for the Malaysian Legal System.

Keywords: FinTech, Cryptocurrency, Central Bank, Blockchain & Financial Regulation

INTRODUCTION

Cryptocurrency is one of the highest FinTech innovations which brought changes to our current existing global finance and economic sector. On a daily basis, we read news related to cryptocurrency on newspaper. Basically, it means digital/virtual currency consisting of a sequential hashing and digital signature which is created via encryptions technique. This process is carried out through work of thousands of computer around the world. We address this process as mining where programme creates tasks and generated computing and give users of the app of “virtual point, points” (Jones, 2018).

Bitcoin, Ethereum, Litecoin are the examples of existing cryptocurrency in our world. Bitcoin is one of the most acclaimed cryptocurrencies among the internet users. Despite the fact of its introduction in 2009, it is still attracted by a large group of people in the world. This is mainly due to the unique nature of the cryptocurrency. The efficiency of transferring around the world and low transaction costs are the leads to the popularity of the currency itself among the people.

However, a high degree of anonymity and decentralised nature of the cryptocurrency creates more problems like being used in illegal activities such as weapon purchases, drug syndicates, terrorism financing and so on (V.A.Petrova, 2018).

The rise of price hike of cryptocurrency and the easy access to the system also further contributes to the call for regulation. The regulatory bodies around the world started to work on the legal framework for the system. Some countries adopted a wait and see approach while a small group of countries decided to adopt the restricted approach while placing a blanket ban on the system. This paper will discuss the need for the regulation of the cryptocurrency system and will review the regulation of cryptocurrency in other countries. Then we will shift to the regulation of digital currency in Malaysia with arguments for and against.

1.1 Problem Statement

The rise of cryptocurrency usage in world alarms our policymakers and law regulator to come up with regulation due to a high degree of anonymity and decentralised nature of the system which associated with its own substantial risk.

1.2 Research Objectives

- 1.2.1 Identify the need for the cryptocurrency regulation in Malaysia
- 1.2.2 Identify the approach taken by other countries towards the regulatory framework for the cryptocurrency
- 1.2.3 Identify whether the current regulatory framework for cryptocurrency in Malaysia is satisfied

1.3 Research Methodology

- 1.3.1 This study is conducted based on the qualitative analysis.
- 1.3.2 Due to the nature of this paper, secondary resources such as news articles, journals, books and law websites from various countries were used.

LITERATURE REVIEW

In a study conducted by Jerry, the author mentioned that the first wave of the cryptocurrency regulation is focused on the protection for the cryptocurrency users. The study also urged the authorities to come up with a detailed regulation which addressed the financial instruments including securities and derivatives. (Brito, 2014)

Based on the study conducted by Ernst and Young, the transaction anonymity of the cryptocurrency is one of the drives for the operational risks. In 2015, the government adapted mixed approach towards the regulation as they don't want to overburden the budding Fintech sector with new pieces of legislation which might affect the transaction of the cryptocurrency system (Peters, 2015).

Based on the study conducted by Finck, it shows that the regulation of cryptocurrency is needed not only to address the drawbacks of the system but to provide legal certainty. The author urged the regulators to come with the legal framework for the system before it matures. The regulators need to consider the flexible nature of the system when drafting the legal framework (Finck, 2017).

In a study conducted by Stephen and Theodor, it is stated that the ultimate nature of the cryptocurrency of not being controlled by any of regulatory bodies is attracted the people to use this system. The cryptocurrency system provides financial freedom to people as it is free from legislation while most of the legislation is enacted in a way that affects their privacy and freedom. However, the rising possibilities of misuse of the cryptocurrency for criminal and terrorism activities call the government for regulation. The study shows that the government has to come with a balanced regulatory system without affects the freedom of transaction (Breu, 2018).

Based on the study by Goldmann, the authorities adopted the wait and see approach towards the regulation of the system in late 2017. However, the unprecedented price hike of Bitcoin and the easy access to the system call for the immediate action from the regulatory bodies. As this system is no more than small glitch in the global financial market. The approach that the authorities decided to adapt has to be clear and detailed. It should not be immediately put into legal guidelines as there are several factors need to be considered. The regulation needs to be flexible without affecting the nature of cryptocurrency (Goldmann, 2018).

THE NEED FOR REGULATION OF CRYPTOCURRENCY

This FinTech innovation is known for ease of payment due to its decentralised system as it is separated from control of authorities like banks. Even though the absence of third-party involvement makes the payment process using digital currency is simple compared to the fiat currency system but there is no check and balance system. There is no single regulatory body controls the system due to the nature of it. In a transaction involves virtual currency, the buyer will send the crypto code to the seller who will exchange it for real money.

When the buyer sends the wrong code or false code to the seller, he can rectify the issue with any other authority as he only knows whereabouts of the seller. There is no person or body that we can hold accountable for. As this is a different case from a transaction that involves fiat currency as each process involves bank where the affected parties can go to the bank for further assistance.

Besides that, the high degree of anonymity also further contributes to the alarming call for the regulation. The transaction involves virtual currency is not popular in a normal transaction but also for the illicit transaction. The fast and not traceable nature of the system attracts the criminal to use for their illegal activities. A large amount of transaction easily transferred to drug syndicate activities. Besides that this also further increases terrorist funding around the world as we cannot trace the source of money like the fiat currency which leaves traces on the regulation process.

Besides that, the unstable of the market of cryptocurrency make difficult for us to replace with our traditional money system. This market is very unstable as it is constantly changing depends on market demand. As the market value sometimes is very high while sometimes becomes very low. This is further affected by market speculation by investors. In general, all of the above factors lead to the call for the need of regulation of the system.

THE WAY CRYPTOCURRENCY MARKET REGULATED GLOBALLY

This article further discusses the way the market is regulated by the countries around the world. Firstly, we are going to see how Australia approaches the cryptocurrency market.

AUSTRALIA

In Australia, the cryptocurrency is classified as an asset where their government has indicated that they are going to exercise control on cryptocurrencies by revising the Anti-Money Laundering and Counter-Terrorism Financing Act by including Bitcoin exchange under the bill for the first time in the legislation (Mclean, 2017). They also going to make rules to expand or narrow the scope of the virtual currency definition. In order to the tight the rules; there will be a number of civil penalties introduced for unregistered operators of virtual currency exchange services.

As it is included under the bill which will be proposed at a later date, this shows the Australian authorities will exercise control on the movement of the cryptocurrency to prevent it to be used for terrorism funding.

Besides that, they also starting to accept cryptocurrency as a legitimate means of payment method by coming up with new legislative amendments on GST where the purchase of cryptocurrency will no longer be subject to GST.

CHINA

In China, the cryptocurrency is classified as a virtual commodity where it is legal for private use but illegal for commercial purposes. The New York Times, citing data by blockchain analysis firm Chainalysis, reported in late June last year that 42 percent of all bitcoin transactions took place on Chinese exchanges in the first half of 2016 (Yeng, 2017). Their government had a harsh and hard-line approach by coming up with a nation-wide ban on initial coin offerings (ICOs) and cryptocurrency exchanges since last September due to curb the illicit activities using cryptocurrency and financial risks associated with the usage of the currency (China Daily, 2018).

This shows that this approach is likely to put an end to cryptocurrency exchanges and ICOs in China for now.

ESTONIA

In Estonia, the cryptocurrency is classified as a virtual currency, one of the payment methods. In 2016, the Supreme Court of Estonia ruled in favor of restrictions on bitcoin trading activity in the wake of a lawsuit filed by a digital currency broker (Higgins, 2016). However, since then, the government appears to have gradually started to accept the cryptocurrencies by recognising its potential benefits and usefulness to society in the future.

This indicates that there will be sets of new pro cryptocurrency legislation in Estonia in future due to the developing market of the virtual currency.

GIBRALTAR

In Gibraltar, the cryptocurrency is classified as a virtual currency, one of the payment methods. The government will introduce the first legal framework to govern the sector (Jones, 2018).

This framework is based on the amendment of the Gibraltar Financial Services (Investment and Fiduciary Services) Act 1989. The framework aims to create a conducive environment for cryptocurrency exchanges to do business, with DLT service providers being provided a working license subject to these companies conforming to certain regulatory principles. These principles include honesty, integrity, the protection of customer assets and maintaining a high degree of cybersecurity.

JAPAN

In Japan, the cryptocurrency is considered as currency denominated-asset but cannot be considered as a legal tender. They came up with a set of regulation for digital currency with the implementation of Virtual Currency Act in April 2017 with the approval of their Financial Services Agency (JFSA). Under this piece of legislation, application of Bitcoin and Ethereum is recognised as a method of legal payment.

In spite of that, the fact of the exemption of both of these cryptocurrencies from Japanese consumption tax shows that these digital currencies are not acquired the same status with an existing fiat currency like Yen.

Besides that, there were also other amendments under this legislation. The requirement of registration of virtual currency exchanges with the JFSA is one of them. This places an obligation on the virtual currency exchanger to conduct proper Know Your Customer (KYC) checks on their customers.

In addition to the above, there are some other stringent requirements which need to be followed by each virtual currency exchanges such as a hold a minimum liquid capital of JPY 10 million, implement a secured IT management programme to safeguard from the hacking of personal details and funds, submission of annual audit by certified public accountant and an auditing firm, and anti-money laundering compliance.

It is important to take note that the regulation on cryptocurrency becomes stricter after the theft of US\$ 500 million from a major Japanese exchange, Coincheck in January 2018. This is considered to be the largest theft act by hackers since the introduction of cryptocurrency in 2009. (Cheng, 2018). The stringent rule makes it difficult for the Bitcoin exchange companies to prove their security credentials with which lead to the shutdown of the companies. Being the largest market for Bitcoin transaction, Japan chooses to adopt the strict approach in the wake of the largest theft.

RUSSIA

In Russia, the cryptocurrency is recognised as an asset but not as legal tender. Well, now we will see their status on regulations. Russia is having a polarising effect on the operation of cryptocurrency. At first, there have been reports circulating that Russia will block access to websites exchanges and trading platforms offering cryptocurrencies like Bitcoin. Russian President, Vladimir Putin's viewed that cryptocurrency exchange can be used in illicit activities like money laundering, tax evasion, and terrorism financing.

In contrary to this view, there was a report released by Kremlin on 21st October 2017 which expressly indicated that there will be an amendment to Russian laws to address the requirements for the cryptocurrency system. Anti Danilevski, Chief Executive Officer of blockchain explained that the main purpose of this new legislation to address regulation on the cryptocurrency but not on the total ban as per the previous view. This shows that Russia started to have a warm approach towards digital currency as opposed to the China who placed a blanket ban on cryptocurrency.

The bill drafted by the Russian Finance Ministry laid out the framework for both the mining and blockchain based transactions. This appears marks a milestone in the regulation of the cryptocurrency as they want to bring the process of mining under the

regulation. This draft also legalised the term of the “digital financial asset” and defined it as a security in electronic form “created using encryption methods, of which the legal title of ownership is verified by making a digital record in the register of digital transactions” (Esteves, 2018).

This draft also established that the cryptocurrencies are not an authorized means of payment in Russia. Despite the fact of the bill will be amended by Parliament, we can see the future of regulation of cryptocurrency in Russia.

SINGAPORE

In Singapore, cryptocurrency recognised as an asset like other countries. At first instance, Singapore government has not imposed any direct rules and regulations on the use of the cryptocurrency as they didn't recognised it as a legal tender. However, their Revenue Authority of Singapore (IRAS) has set out guidelines on the taxation of profits derived from the trade of digital currencies. Few points from the guidelines are set below:

- The business which accepts the virtual currencies as payment for their goods and services should be recorded according to the open market value of their goods and services in Singapore dollars.
- Where the open market value of their goods and services cannot be determined in Singapore dollars, the sale can be recorded based on the virtual currency exchange rate at the point of the transaction.
- Businesses will be taxed on their profits gained from trading in the virtual currency.
- Where businesses buy virtual currencies for the purposes of long-term investment, profits will be treated as capital gains and are therefore non-taxable.

In the beginning, the Monetary Authority of Singapore (MAS) decided not to intervene by regulating the cryptocurrency payments as it was more of a commercial decision. However, the Singapore government realized the adverse effect that may arise from cryptocurrency which resulted in them to set up regulations for the virtual currency intermediaries.

The first stage of this regulatory framework would be placing all virtual currency intermediaries including ICOs to be governed by the MAS which was reinforced on 1st of August 2017. This is followed by the Consultation Paper issued by MAS in November 2017 which places all form of cryptocurrency trading as a regulated activity under the bill and would also require the virtual currency exchanges to have payment service license.

In addition to the above, there is speculation of the idea of cryptocurrency being regulated by the central bank is not accepted by Ravi Menon, the managing director of the Monetary Authority of Singapore. He reaffirmed that this is not a wise method to put the burden on the central bank to issue digital currency to non-bank public. He assured that the financial stability has predominance over financial development” (Noonan, 2018).

In short, there will be the warm approach towards regulation of cryptocurrency in Singapore.

SOUTH KOREA

In South Korea, cryptocurrency is not considered as money or currency, or financial products. South Korea indicated that they are going to follow China's footsteps by imposing a blanket ban on all ICOs. In contrary to the above, their policy makes indicated that they will come up with regulations to govern the cryptocurrency. However, before the implementation of this, number of South Korea's exchanges were hacked which makes them rethink again about the blanket ban.

Instead of that, they have decided to make stricter rules. In Korea Times, it reported that they are preparing a policy plan for ICOs subject to certain conditions which will open the door for Korean companies to raise fund on the crypto market (Yoo-chul, 2018). In short, South Korea also going to have a positive approach to towards the regulation on the cryptocurrency despite the earlier decision to come up with a blanket ban.

SWITZERLAND

In Switzerland, cryptocurrency is recognised as legal method or payment. In contrast with the other countries, Switzerland is one of the largest hubs for cryptocurrency and the blockchain technology they are built on. It is important to take note that the first Bitcoin ATM was set up four years ago in Zurich. In addition to it, a new category of companies which in high tech circles has been dubbed as Crypto Valley (Lyford, 2018). The rise in a number of blockchain companies gave the wake-up call to the Swiss Financial Market Supervisory Authority FINMA to come up with new regulations.

FINMA come up with regulations to create transparency in the cryptocurrency market due to the risk of money laundering. The guidelines can be categorised into three which are set below:

- Payment ICOs (tokens that can be used for payment, or otherwise transferred). In this instance FINMA require compliance with the AML regulations;
- Utility ICOs (tokens not qualifying as securities, only existing to confer digital access rights to an application or service). If developed or seen to be used as a 'Payment ICO', the aforementioned will apply; and
- Asset ICOs (tokens acting clearly as securities). This type of token will strictly be required to adhere to securities regulation and extend as far as civil law requirements in trading: the 'Swiss Law of Obligations'.

The guidelines clearly set out but the efficiency of it still yet to be known. In short, Switzerland drew the line and once the result of the real game established, other countries will follow their footsteps.

UNITED KINGDOM

In the United Kingdom, cryptocurrency is recognised as assets. In late October 2017, UK government was in midst negotiation in amending the 4th Anti-Money Laundering Directive which will cover the digital currency exchange and custodian wallets to curb it from being used for illegal activities. Due to the Brexit where UK officially exit from European Union from 26 March 2019, UK government has decided to come up with their own legislation to address the growing market of cryptocurrency.

This was confirmed by Governor of the Bank of England (BoE) Mark Carney who stated in Investment Week that the UK government has set for a new wave of cryptocurrency regulations to address the financial stability risks and financial crime. (Sheen)

He added that the despite the fact of the positive impact arising from the application of cryptocurrency, the legal framer is needed to address the risks posed.

On 22 March 2018, a new Cryptoassets Task Force was set up by the Treasury, Bank of England and Financial Conduct Authority (FCA) to discuss and address the risks of crypto assets, the benefits of new FinTech and its influence (Browne, 2018). The UK's Chancellor of the Exchequer, Philip Hammond explained that the task force will study this new technology in detail and will address the risk associated together with the potential impact posed to the financial sector not now but on future as well. Rather than imposed restrictions like China, UK has decided to accept cryptocurrency as it is one of the leading innovations in FinTech. The Taskforce result will be released on this summer and then we can see their way of regulations in tackling the risks we spoke out.

UNITED STATES OF AMERICA

In the United States of America, cryptocurrency is recognised as a commodity along with gold. Initially, in an analysis by Business Insider, the law review stated that the U.S federal government has not exercised its power to come up with regulation for the country as a whole which gives freedom for each state to enact their own regulation for the cryptocurrency. One of the examples is New York state who started to regulate the cryptocurrency companies state agency rulemaking in June 2015.

On 14 March 2018, the Subcommittee on Capital Markets, Securities, and Investment meet up to discuss the future and development of cryptocurrency in U.S. However, the committee members have different view on the regulation of cryptocurrency On party viewed that there is no need for regulation of cryptocurrency as state government has sufficient freedom to come up with their own. While the other side of party calls for the need of regulation for the nation as a whole.

In addition to the above, there were arguments going on in term of classifications of the cryptocurrency where the burden in determining such is pushed to the large watchdogs which are The Commodity Futures Trading Commission (CFTC) and US Securities and Exchange Commission (SEC)

In short, U.S government is already on their halfway in enacting regulation on the whole. We can take a wait and see the approach in this matter.

CURRENT STATUS OF CRYPTOCURRENCY IN OUR COUNTRY

We have looked through on the regulations in other countries and some of the countries place a blanket ban on the application of the cryptocurrency while rest are coming up with regulation to place check and balance on the system. Some countries are still sitting on the fence in deciding whether to accept this digital currency into their financial sector due to the risk associated with the system.

While the current situation in Malaysia is we took a warm approach towards the cryptocurrency. We have been thinking about the regulation on the cryptocurrency. There a lot of debates occurred between the lawmakers and finance bodies for the past few years.

In the year 2017, there were 11 cryptocurrency exchanges in Malaysia (Jayaseelen, 2017). Our lawmakers decided to come up with a warm approach towards the system. The result of the long discussion is announced in February 2017 where Malaysian government has come up with new legislation which placed check and balance system on the cryptocurrency.

The new legislation reads as Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) is come to effect on 27 February 2018 (Haig, 2018). This legislation marked the biggest history for the FinTech industry in Malaysia as the new piece legislation is brought to the cryptocurrency under the umbrella of regulation. This legislation is drafted based on the feedback received from the public of the paper in December 2017.

Our central bank stated that the main reason for this legislation is to impose an obligation on the cryptocurrency exchangers mainly on the business which involved cryptocurrency transactions. This result from the feedback received from the public during the public consultation period in December 2017.

The major impact of this legislation is imposing a duty on cryptocurrency users to conduct customer due diligence either known CDD. The extract of the guidelines are set below:

Reporting institutions are required to:

- (a) Identify the customer and verify that customer's identity using reliable, independent source documents, data or information;

- (b) Verify that any person purporting to act on behalf of the customer is so authorised, and identify and verify the identity of that person;
- (c) Identify the beneficial owner and take reasonable measures to verify the identity of the beneficial owner, using relevant information or data obtained from a reliable source, such that the reporting institution is satisfied that it knows who the beneficial owner is; and
- (d) Understand and, where relevant, obtain information on, the purpose of the business relationship (Gazette, 2018).

This means that each and every of cryptocurrency exchangers needs to identify and verify the customer who involves in this trade with them which wasn't the case prior to this. This places the onus on the registered cryptocurrency exchangers to identify their customer.

The new regulations require cryptocurrency exchanges to collect a trader's full name, address, date of birth and the customer's ID (Pikri, 2018). This is applicable to "any person offering services to exchange digital either from or to fiat money, or from or to another digital currency. (Lieberman, 2018).

Malaysian Central Bank has confirmed that cryptocurrency is not recognised as legal tender as it is protected by prudential and bank standards. In short, Malaysian government placed the onus on the cryptocurrency users.

CONCLUSION

This paper discusses the policy approach taken by other countries due to the risks associated with cryptocurrency and also Malaysia's approach towards cryptocurrency. Malaysian regulation indicated that the onus on users of the cryptocurrency. In order to control the growing crypto market, Malaysia authorities need to include the mining process under the regulation. This is to monitor the process of cryptography with the efficient cyber system.

In addition to, due to the decentralised system, the control from the central bank is needed as well. This is to place the Central Bank as the highest to exercise control on all the crypto creation process and also the transaction as well. This article proposes the government needs to come up with a more detailed legal framework which includes the above suggestion.

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