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TABLE OF CONTENTS

Note from the Editor-in-Chief	2
About the Editors	4
HKMA launches Project Ensemble Sandbox to test tokenisation use cases in Hong Kong	5
The European Blockchain Sandbox	7
Navigating Blockchain Innovation in Cyprus: Regulatory Advances, Challenges, and the Path Forward	12
Regulating a Borderless Industry: Challenges and a Path Forward for Crypto Markets	16
A Brief Legal Tour of Initial Exchange Offerings (IEO) in Malaysia	22
The Future of Global Information Reporting for Digital Assets: Unpacking the OECD's Crypto-Asset Reporting Framework (CARF) and CRS Amendments	27
Crypto Fire Sales: a Primer on Crypto Bankruptcy Auctions and Transactions	31
Panel: Clifford Chance live stream panel session-Exploring the Tokenization of Assets and Funds	35
International Handbook of AI Law	36
Get Involved with IJBL	38

NOTE FROM THE EDITOR-IN-CHIEF



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Welcome back to the 10th and the anniversary edition of the IJBL I am extremely excited of having published 10 editions in cooperation with the GBBC. So many thanks to Sandra Ro, the entire GBBC team, the board of editors and all the contributors.

First and foremost, Nina Moffatt from the law firm Paul Hastings in London has recently joined the board of editors replacing Laura Douglas. A warm welcome to you, Nina!

This edition again features a wide array of excellent crypto- and blockchain related topics from Malaysia, Germany/Netherlands, Austria, Cyprus, United Kingdom, United States and Hong Kong. As mentioned in the Editor's Note of the last issue, I envisage to bring the various blockchain sandbox initiatives of regulators to your awareness.

In the previous issue, we shed light on the sandbox initiative of the Bank of Thailand. In this edition, we also remain in the APAC region and start off with an article from Etelka Bogardi from Norton Rose Fulbright Singapore/Hong Kong who talks about the Project Ensemble Sandbox set up by the Hong Kong Monetary Authority (HKMA) on August 28, 2024 aimed at exploring asset tokenization use cases and the settlement of tokenized asset transactions. Project Ensemble Sandbox has been designed as a new financial market

infrastructure that facilitates the full lifecycle of a tokenized asset transaction, starting from the creation and trading of tokenized assets, through payment and settlement using tokenized commercial-bank deposits, to final interbank settlement using wholesale CBDC issued by the HKMA.

Michael Jünemann and Marjolein Geus from Bird & Bird law firm (Germany / Netherlands) share insights and best practices defined in the European Blockchain Sandbox ("Sandbox) which is a European Commission initiative. It has been set up to create a pan-European framework for a cross-border regulatory dialogue between blockchain/DLT innovators in the private and public sector and regulatory authorities on national and EU levels. The Sandbox is organized by a consortium led by Bird & Bird, amongst others. Marjolein is the lead organizer of the Sandbox and Michael is leading the financial services dialogues within the Sandbox.

Mikaela Kantor from DS Partners Law Firm in Cyprus explores the current DLT and blockchain regulatory landscape in Cyprus, particularly showcasing its alignment with EU regulation such as MiCAR. Interestingly, Cyprus has adopted a National Blockchain Strategy which set the ground for further developments such as the launch of the Regulatory Sandbox issued by the Cyprus Securities and Exchange Commission. It is fascinating to see how small countries like

Cyprus are taking over roles as key players in the European blockchain landscape, driving both economic growth and technological advancement.

James Contos, Lucia Tsoi and Raphael Landesmann from the GSR Markets London investigate the approach taken to cross border market access in the European Union, United Kingdom and the United States and the issues that have arisen with these jurisdictions. They propose a set of principles to establish a safe but innovation-friendly cross-border market access framework which reflects the global and borderless nature of crypto assets.

Edmund Yong from Celebrus Advisory Malaysia, and Ming Chiek Gan and Kelvin Wong, both from GLT Law Malaysia, provide an overview of the state of play on the current regulatory and legislative framework of Initial Exchange Offerings (IEO) in Malaysia, also considering its Shariah compliance. IEO is a permutation of the Initial Coin Offering and is conducted through a digital asset exchange. The authors conclude that regulations in Malaysia will continue to develop in that space, encompassing the full lifecycle of digital tokens and the asset servicing infrastructure.

Further, Dr Max Bernt from Taxbit Austria sheds light on the key components of the Crypto Asset Reporting Framework (CARF) and explains how this new regime might affect internal tax compliance procedures. Endorsed by the G20 and supported by over 60 participating jurisdictions, CARF establishes a standardized approach for the reporting of crypto assets to tax administrations. Max points out that CARF is not intended as a tool for calculating crypto tax liabilities. However, it will play a crucial role in supporting tax administrations globally by providing a powerful mechanism for risk assessment and to identify high-risk cases and potential tax evasion in the digital asset space.

Darren Azman, Joe Evans, and Shawn Helms from McDermott Will & Emery LLP (Dallas) illustrate the state of play in the US when it comes to crypto bankruptcy transactions. They point out that many components of crypto asset restructuring require the ability to adapt and anticipate moving targets due to evolving regulations, volatile asset values, and unique transaction complexities. This timing uncertainty inherent to crypto assets necessitates special considerations aimed at mitigating potential financial losses.

We conclude this edition with a link to a recording of the October 1, 2024 podcast of the Clifford Chance/GBBC panel discussion on “Exploring the Tokenization of Assets and Funds”.

Finally, I would like to do a bit of self-promotion again: In November this year, the International Handbook of AI Law, which I have contributed to as an editor, will be published. You can find the flyer on the last page of this issue.

Happy reading and listening.

Dr. Matthias Artzt
Editor-in-chief

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Nina Moffatt is a partner in the London office of Paul Hastings providing legal and commercial advice on regulatory requirements across Europe. She has particular expertise in large cross border offerings and product design. She also regularly assists clients with their relations with the U.K. regulators, including applications for authorization and supervisory issues.

ARTICLE I



HKMA LAUNCHES PROJECT ENSEMBLE SANDBOX TO TEST TOKENISATION USE CASES IN HONG KONG



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On 28 August 2024, the Hong Kong Monetary Authority (**HKMA**) launched the Project Ensemble Sandbox (Sandbox) to explore asset tokenisation use cases and the settlement of tokenised asset transactions. The Sandbox is a crucial component of Project Ensemble, which launched in March 2024, to explore new financial market infrastructure (**FMI**) to facilitate seamless interbank settlement of tokenised money using wholesale central bank digital currency (**wCBDC**).

THE SANDBOX

The Sandbox has been designed as a new FMI that facilitates the full lifecycle of a tokenised asset transaction, starting from the creation and trading of tokenised assets, through payment and settlement using tokenised commercial-bank deposits, to final interbank settlement using wCBDC issued by the HKMA.

The initial round of experimentation under the Sandbox will explore tokenisation of both traditional financial assets and real-world assets under the following [themes and use case categories](#):

- fixed income and investment funds – bond and fund;
- liquidity management – repo and treasury management;
- green and sustainable finance – carbon credits and EV charging stations; and
- trade and supply chain finance – supply chain finance and trade finance and payments.

Cross-border payment functionalities will also be an element of the Sandbox. As noted in our [previous update](#), the Banque de France (**BdF**) and the HKMA announced in June 2024 that they had entered into a Memorandum of Understanding to promote innovation in the wCBDC and tokenisation market. At the Sandbox launch, the HKMA's Chief Executive Eddie Yue [highlighted](#) that the Sandbox and the BdF's equivalent system (i.e. the Distributed Ledger for Securities Settlement System (also known as DL3S)) have been successfully connected and pilots have demonstrated that atomic cross-border settlement can be performed through the linked systems.

The Securities and Futures Commission (SFC) has announced that it will co-lead the tokenisation initiatives for the asset

management industry under the category of fixed income and investment funds to promote wider adoption of tokenisation.

The SFC will work with the HKMA to provide regulatory guidance and address industry's concerns that arise from these use cases.

The launch of the Sandbox follows the establishment of the Project Ensemble Architecture Community (the **Community**) in May 2024. The Community comprise a diverse spectrum of industry representatives from banks, technology companies, regulators (including the SFC) to academics. Its aim is to develop a set of industry standards to support interoperability among wCBDC, tokenised money and tokenised assets. Banks that are part of the Community have connected their tokenised deposit platforms to the Sandbox, which allows participants of the Sandbox to experiment with both interbank payment-versus-payment and delivery-versus-payment settlement.

The HKMA also noted that it will be seeking to collaborate with the Bank of International Settlements Innovation Hub Hong Kong Centre, which the HKMA has previously worked with on other tokenisation projects, such as **Project mBridge** and **Project Genesis**, as well as the CBDC Expert Group (a group of academics with expertise relevant to HKMA's research work on CBDC and a Community member), to further advance the Sandbox.

LOOKING TO THE FUTURE

The Sandbox has been designed in a way that will enable it to support various forms of digital money and digital assets beyond those explored in the initial round of experimentation under the Sandbox. **Through the Sandbox, industry participants will be able to experiment with new tokenisation ideas and bring those to the market in the future.**

At this early stage, the HKMA is already actively working to evolve the Sandbox into a production-ready FMI that will support real-

money tokenised transactions in Hong Kong in the future.

The cooperation between the HKMA and the SFC on Project Ensemble signals the efforts by the regulators to promote tokenisation and the development of a common standard for tokenised asset settlement in Hong Kong.

ARTICLE II

THE EUROPEAN BLOCKCHAIN SANDBOX



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INTRODUCTION

The European blockchain regulatory sandbox is an European Commission (EC) initiative that creates a pan-European framework for a cross-border regulatory dialogue between blockchain/DLT innovators in the private and the public sector and regulatory regulators and authorities on national and EU level³. It aims to enhance legal certainty for innovative blockchain/DLT applications and facilitate the development of best practices in this area.⁴

The term “sandbox” is used for different testing environments that often involve testing and/or derogation from existing legislation or regulatory approval. The characteristics of the European

Blockchain Sandbox are different compared to these other sandboxes. The European Blockchain Sandbox provides a framework for a confidential and informal cross-border regulatory dialogue between regulators/authorities and innovators covering a range of different regulatory areas. Use cases that are participating in the European Blockchain Sandbox are selected on the basis of transparent and non-discriminatory application terms and selection criteria. The European Blockchain Sandbox does not provide a framework for derogation of certain laws or regulations and the participating use cases are not “approved” by the participating regulators/authorities. Also, the dialogues that are taking place as part of the European Blockchain Sandbox are normally less time-consuming than participation in a sandbox that includes regulatory and operational testing. Best practices, lessons learned and areas for clarification that are identified during the regulatory dialogues are made available for the wider community through the publication of best practices reports and public webinars.

The sandbox is open for a broad range of blockchain/DLT use cases in the public and the private sector, also in combination with other technologies such as AI and IoT, with an emphasis on topics that are of relevance across sectors and regions. Particular focus is on areas of application where novel legal and regulatory questions arise in the financial sector and other key

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² Marjolein Geus is the project leader for the European Blockchain Sandbox and a Bird & Bird partner specialising in European and international regulatory and multi-jurisdictional projects in the communication and technology sectors and leading the Global Tech & Comms Group as well as being the head of the international Sector Regulation and Consulting practice of Bird & Bird.

³ Regulatory authorities could range from competent authorities entrusted with supervision and enforcement of regulation or regulators with a role in the development and implementation of regulations.

⁴ <https://ec.europa.eu/digital-building-blocks/wikis/display/EBSI/Sandbox+Project> (zuletzt abgerufen am 20.11.2023).

sectors such as sustainability, health, supply chain and logistics/trade, mobility and energy. Important regulatory areas include financial sector regulation, data protection and regulation of non-personal data, ESG regulation, Electronic Identification, Authentication and Trust Services (eIDAS), cyber security regulation, consumer protection, smart contracts for automated data processing, liability issues and AML/KYC rules.

II. THE CLASSIC “REGULATORY SANDBOX”

Compliance with the regulatory requirements in the financial sector⁵ is not only associated with a certain organisational effort, but also with greater financial expenditure. In particular, the licence requirement in financial sector regulation will make it more difficult for young companies, in particular to enter the market⁶ and, under these circumstances, there is also a certain amount of risk: they will have to invest time and money in order to be able to launch their business on the market at all. However, they often have no opportunity to evaluate their business model in advance and have increased difficulties in assessing its market opportunities on the basis of test series. This can create a high barrier to market entry for young entrepreneurs particularly, but also for more mature entrepreneurs, and consequently lead to innovations being prevented. The so-called classic “regulatory Sandbox” in the financial sector is a concept that offers financial institutions and companies a controlled space to test innovative fintech solutions with the support

⁵ In principle, the provision of banking business within the meaning of Section 1 Paragraph 1 of the German Banking Act (*Kreditwesengesetz – KWG*) or the provision of financial services within the meaning of Section 1 Paragraph 1a KWG is subject to a licence requirement in accordance with Section 32 KWG and the provision of financial services within the meaning of Section 2 Paragraph 2 of the German Investment Firm Act (*Gesetz zur Beaufsichtigung von Wertpapierinstituten – WpIG*) is subject to a licence requirement in accordance with Section 15 WpIG. This means that in these cases, a licence must be applied for from the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin*) before business is commenced.

⁶ *Krimphove/Rohwetter*, BKR 2018, 494, 495.

of an authority for a limited period of time so that they can validate and test their business model in a secure environment and thus preventing the above-mentioned supervisory regulations problems⁷

III. OVERVIEW OF THE PROJECT “EUROPEAN BLOCKCHAIN SANDBOX”

The European blockchain regulatory sandbox for DLT projects was launched in 2023. However, as mentioned above this is not a classic regulatory sandbox for testing a business model, but a framework to enhance a cross-border regulatory dialogue between authorities/regulators and innovators in a safe and confidential environment. Every year, starting in 2023, 20 innovative DLT/Blockchain use cases are selected covering different industry sectors and EEA regions to engage in the confidential and informal cross-border regulatory dialogues with relevant national and EU regulators and authorities. To the extent that best practices/recommendations are identified during the confidential and informal dialogue meetings that can be shared with the wider community, these are published in the form of best practices report, but only with the consent of the participants and never with a link to individual use cases.

Herefore, the selected use cases in the 1st cohort have been successfully matched with well over 50 national and EU regulators/authorities from across the EU/EEA and covering a broad range of regulatory areas. The results of the regulatory dialogues for the 1st cohort have been shared with the wider community as a best practice report in June 2024 without disclosing confidential information in order to facilitate a secure and confidential dialogue on relevant regulatory issues allowing innovators to understand better relevant laws and regulations and allowing authorities and regulators to understand

⁷ EBA/DP, 2017/02, p. 7

better innovative DLT technologies from a regulatory and legal perspective.⁸

As mentioned the reports with best practices and lessons learned as a result of the combined experiences will always respect confidentiality from the part of the use cases and the regulators/authorities. The approach during the dialogues of the first cohort depended on the use case and the area(s) of regulation:

- Several dialogues focused on regulatory compliance by DLT/Blockchain use cases. Examples are the dialogues with a focus on the GDPR, Cyber Security, AML and Financial Sector regulation. During these dialogues, valuable guidance was provided by the participating regulators/authorities to the use cases which resulted in best practices and lessons learned which are presented in the best practices report.
- Other dialogues focused on how the use of DLT/Blockchain applications can support efficient and effective compliance and oversight. Examples of the use of Blockchain/DLT as an extra tool, making compliance and oversight more efficient, were discussed in the customs area, Battery Passports/DPPs, Cultural Asset Passports and CO2 reporting (EU ETS/MRV). The use of Blockchain/DLT for mandatory monitoring, reporting and oversight will likely become a relevant area for the dialogues in the next cohorts.
- Finally, the dialogues for some use cases focussed on EU regulation as a facilitator such as (i) the use of the EUDI Wallet and new categories of qualified trust services in scope of the eIDAS Regulation, (ii) the possibility to qualify as a recognized Data Altruism Organisation in the sense of the Data Governance Act, as a possibility to enhance credibility of a Blockchain/

DLT use case and (iii) the harmonised regulatory framework of the Markets in Crypto-Assets Regulation (MiCAR).

The Sandbox is organised by a consortium led by Bird & Bird with its consultancy arm OXYGY and blockchain experts from Warren Brandeis while the website development is undertaken by Spindox. A panel of independent academic experts from European universities is overseeing the application and selection process for the annual selection of use cases and is in the lead for the annual most innovative regulator award.

IV. OBJECTIVES OF THE EU BLOCKCHAIN SANDBOX

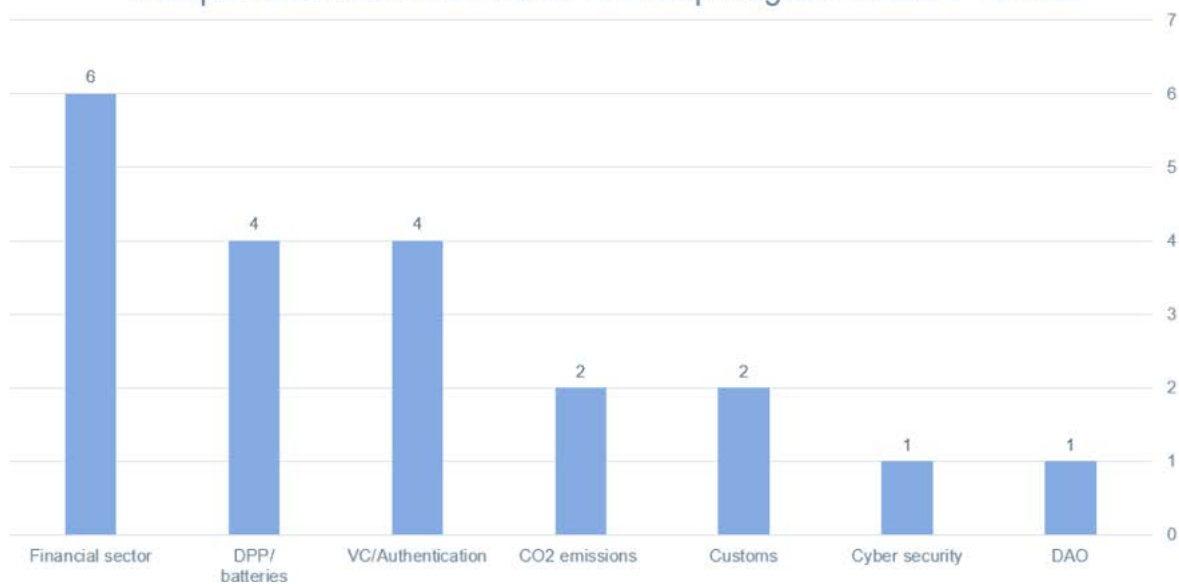
Blockchain/DLT innovators are to be given a better understanding of the regulatory framework for compliance reasons and also to make use of EU regulatory instruments. In addition, the project aims to raise awareness among authorities, public bodies and blockchain/DLT innovators for a better understanding of innovative technologies and potential regulatory challenges as well as possible solutions. **Furthermore, the project aims to identify best practices and lessons learned which are shared in the form of annual best practice reports.**

V. COURSE OF THE SELECTION PROCEDURE

For each cohort, the programme set-up and the application and selection process are important. Applications for the 1st cohort could be submitted using a form that was made available via the project website ([link](#)) and could be submitted until 14 April 2023. Uploading and completing the forms involved time and effort for the participants, as information about the use case and the selection criteria was requested in detail. By the end of the application term almost 90 applications had been received from across all EU/EEA regions. The selection by independent blockchain experts and a panel of independent academic experts was completed by the end of June 2023.

⁸ Link to the complete best practices report for the 1st cohort: [European Blockchain Sandbox releases the complete Cohort 1 Best Practices Report \(europa.eu\)](#).

European Blockchain Sandbox – Participating use-cases 1st cohort



At the beginning of 2024, the same process for the second cohort was accomplished. Projects of this cohort are announced and can be found online [here](#). The application period for the third (2025) cohort will likely start at the end of this year.

The selection is based on the selection criteria published on the project website. Firstly, the basic eligibility criteria must be met. These are mandatory conditions that determine the applicants' eligibility to participate in the blockchain sandbox. Eligible applications are scored against three different award criteria: i) maturity of the business case, ii) legal/regulatory relevance and iii) contribution to the wider EU policy priorities. In addition, there is a categorisation into four different lots: "micro", "small", "other" and "public institutions".

There are different tiebreaker rules: One is the presence of regulator/authority support if the use cases in the final shortlist of candidates have similar scores that qualify them for selection. In addition, an eligible use case is favoured over other candidates if an EEA region would otherwise not be represented in the final shortlist of candidates. Finally, technical novelty of the use case is applied as a tiebreaker if candidates have similar scores in the final shortlist that are not resolved by the other tiebreakers.

Following the selection, the regulatory focus areas for the dialogues for each of the use-cases are determined. The relevant national and EU regulators and authorities are

contacted to provide them with information about the sandbox and the rules and to invite them to participate. More than 50 authorities and regulators from different regulatory areas participated in the dialogues for the first group of 20 use cases,⁹ which represented all EU/EEA regions and a range of industry sectors (including one EBSI use case proposed by the European Blockchain Partnership). The financial/crypto asset applications were well represented but not dominating, and a broad variety of other use cases was represented in the first cohort, covering areas such as verifiable credentials/authentication, CO2 emissions, digital product passports, cultural asset passports, customs, cyber security, data sharing and DAOs.

VI. ADVANTAGES OF THE EUROPEAN BLOCKCHAIN SANDBOX

The European Blockchain Sandbox offers many advantages both for the operators of the blockchain/DLT use cases and for the regulators/authorities involved:

1. Advantages for participants

Participating blockchain/DLT providers in the project receive specialised legal and regulatory advice to enhance effective and efficient

⁹ <https://ec.europa.eu/digital-building-blocks/sites/pages/viewpage>.

compliance and the use of applicable EU regulatory instruments.

Furthermore, the Sandbox offers use case owners the opportunity to engage in a constructive dialogue with various national and EU regulators and supervisory authorities, where they can communicate and clarify the need for guidance and legal certainty in a secure and confidential environment.

In addition, use case owners have the opportunity to expand their network by participating in this pan-European project, while no fees are charged for applying and participating in the Sandbox.

2. Advantages for regulatory authorities

The European Blockchain Sandbox also offers many opportunities and benefits to European regulators and authorities.

They are given the opportunity to discuss regulatory issues that have arisen at national level in a cross-border environment in connection with concrete innovative blockchain/DLT use cases and the chance to share experiences and ideas with innovators and other regulators and authorities. They will be able to enhance their knowledge of cutting-edge technologies and have the chance to be recognised as the “most innovative regulator”.

In addition, by participating in the project, they will have the opportunity to include relevant regulatory topics for discussion and to contribute to the development of best practices and lessons learned, which are published in the aforementioned best practices reports.

VII. PROSPECTS

DLT and blockchain are relatively new technologies and have become indispensable in today's world. DLT and blockchain technologies are becoming more and more relevant for virtually all national and EU regulators and supervisory authorities.

The 1st round of regulatory dialogues resulted in a broad range of best practices, lessons learned and recommendations which are presented in the complete best practices report for the 1st cohort.

Feedback from the 1st cohort of selected use cases and participating regulators/authorities was very positive. The use cases appreciated the legal/regulatory guidance and the possibility to have an open dialogue with regulators/authorities. The regulators/authorities appreciate to learn more about DLT use cases and to have a cross-border dialogue with other national and EU regulators/authorities. Almost all regulators/authorities were interested to participate again in the next round of dialogues (depending on use cases and regulatory areas/topics) and many regulators/authorities have shared helpful feedback and recommendations for possible improvements for the next rounds of dialogues.

The 2nd and the 3rd cohort will allow for deeper dives into the various regulatory topics and to take account of new legal/regulatory developments and further innovations a.o. in the combination of technologies (blockchain/DLT in combination with AI or IoT).

In concluding, the establishment of the European Blockchain Sandbox is an important step towards promoting innovation in this area within the EU/EEA and thus making Europe an attractive location for innovative companies. The European Blockchain Sandbox creates the opportunity to support innovation within a legally secure framework. Here, the EU can seize the opportunity to be a positive example in the “patchwork” of different regulations for DLT and blockchain technologies worldwide. The cooperation and dialogues in the context of the European Blockchain Sandbox will lead to a better mutual understanding and a more effective and efficient application of relevant laws and regulations. Regulation is important for the market and also serves to protect consumers in particular and does not have to hinder future innovations and the EU's economic area. The European Blockchain Sandbox makes an important contribution here.



NAVIGATING BLOCKCHAIN INNOVATION IN CYPRUS: REGULATORY ADVANCES, CHALLENGES, AND THE PATH FORWARD



MIKAELA KANTOR
ADVOCATE & PARTNER
DS PARTNERS

INTRODUCTION

Blockchain technology is reshaping industries globally, and Cyprus is positioning itself to become part of this transformation. Known for its strategic geographical location and European Union membership, Cyprus is increasingly attracting attention from businesses interested in adopting emerging technologies and exploring innovation in their respective industries. Cyprus' growing payments and financial services sector alongside its favourable stance towards distributed ledger technology (DLT) and its fast-developing fintech sector, put Cyprus on the hotspot jurisdiction list¹ for projects engaging blockchain, DLT and other innovative technologies such as AI.

Cyprus has since 2019 adopted a National Blockchain Strategy which set the ground for further developments, with the most recent one being the launch of the Regulatory Sandbox of the Cyprus Securities and Exchange

Commission ("CySEC"); both acts constituting big strides in creating a regulatory environment that fosters innovation.

This article provides an overview of Cyprus's DLT and blockchain regulatory landscape journey, explores the current legal challenges, and provides an insight on the envisaged and future path forward.

BLOCKCHAIN TECHNOLOGY IN CYPRUS: A QUICK OVERVIEW

On 04 June 2018, the Republic of Cyprus signed the European Blockchain Partnership² and on 04 December of the same year the joint "Declaration of the Southern Mediterranean Countries on

¹ Cyprus was listed as one of the top three hotspots for blockchain technology in Europe by the European Blockchain Observatory Forum (published in 2020)

² The **European Blockchain Partnership (EBP)** is a collaborative initiative launched by 29 European countries, including all European Union (EU) member states and several non-EU countries (such as Norway and Liechtenstein). Established in 2018, the partnership's goal is to create a European-wide infrastructure that leverages blockchain technology for cross-border services, ensuring high levels of security, transparency, and trust.

Distributed Ledger Technologies” with six other European member states (Malta, France, Greece, Italy, Portugal, and Spain). Both agreements aimed to strengthen digital cooperation and position Southern Europe as a leader in cutting-edge technologies like DLT.

In 2019, Cyprus adopted its National Blockchain Strategy which laid the framework for leveraging blockchain in the public and private sectors to drive innovation, boost economic growth and enhance transparency. As part of the Strategy, CySEC launched its Innovation Hub initiative to support businesses introducing innovative blockchain-based financial products and services. The Innovation Hub is still active and in June 2024 launched the Regulatory Sandbox of CySEC, as described further down.

Through the COVID-19 years (2020 & 2021) the Cyprus government launched numerous projects calling on the technology and blockchain communities to collaborate in developing solutions based on DLT that would solve, among others, the COVID-19 and lockdown problem, targeting the medical, corporate and public government spheres. The response was extensive and many of those primary solutions have since been developed and adopted in their respective industries.

Later in September 2021, the Ministry of Finance announced a public consultation on a proposed draft law regulating matters relating to DLT, including blockchain (the “DLT Law”). The draft DLT Law aimed at introducing in a technologically neutral manner rules that would achieve a balance between the need to promote and properly use new technologies and the need to prevent money laundering and safeguard the rights of consumers. It focused on regulating the use of blockchain technology and virtual currencies, ensuring a transparent, secure and compliant environment for fintech innovations. This legislative framework, albeit still in development, was the initial step

towards positioning Cyprus as a key player in the blockchain and fintech space in Europe.

RECENT DEVELOPMENTS

Cyprus is strategically positioned to grow as a strong participant in the blockchain and crypto-asset investments leveraging its established expertise, regulatory know-how, and industry readiness. These strengths can be harnessed to create a flexible yet well-regulated environment in which crypto-asset investments can thrive.

The CySEC has taken significant steps towards adopting a more technology-friendly approach, having recognised the strengths of the industry and the need to foster a trusted environment for service providers to expand their businesses.

Consequently, and in its efforts to provide an initial legislative framework to regulate entities undertaking investments in cryptocurrencies and/or other crypto-related assets, as well as adopt the provisions of the EU 5th Anti-Money Laundering Directive (AMLD5), CySEC published Directive R.A.A 269/2021 on the registration of crypto-asset service providers (the “CASP Directive”). The CASP Directive regulates the registration and authorisation of crypto-asset service providers (CASPs) and the provision of investment services related with crypto-assets. To this extent, CASPs established in the EEA, are required to obtain the prior authorisation of CySEC to offer their services in Cyprus including the (i) provision of investment advice, (ii) reception and transmission of orders, (iii) execution of orders; and (iv) exchange of cryptoassets and/or fiat currencies and/or between cryptoassets. **As a result, Cyprus has enabled the option for CASPs to undertake activities in and out of Cyprus.** Consequently, various significant market players in the crypto-asset industry have obtained a CASP license and Cyprus now hosts branches of entities such as Etoro (Europe) and Naga X operating as crypto-asset service providers.

The CySEC Regulatory Sandbox launched on 11 June 2024³ is another milestone in the response of the regulator to the experts and market participant's needs.

Through this new initiative, CySEC seeks to strike a balance between technological innovation, investor protection and market integrity while supporting the launch of new businesses via a controlled testing environment. **The Regulatory Sandbox is designed for both regulated and unregulated firms to test with CySEC their technologically innovative solutions and/or products related to financial activities which are subject to CySEC's supervision.** The testing of pioneering products, services, and business models within a controlled, time-bound, testing environment will enhance CySEC's understanding of innovative technologies and facilitate continuous regulatory adaptation to new market developments.

Another noteworthy structure for entities seeking to adopt blockchain solutions and undertake investments in digital and crypto-assets is the Alternative Investment Fund with Limited Number of Persons (AIFLNP) option, which due to its fewer restrictions on investment strategies facilitates investment in crypto-assets, despite the absence of a specific national framework governing such assets. The AIFLNP, introduced under Cypriot law in 2014 (implemented in 2019), is recognized for the regulatory flexibility it offers investors. Although capped at 50 investors across compartments, this fund type allows for greater flexibility in investment strategies, such as the ability to invest 100% in a single asset class. AIFLNPs may also operate without a depository, subject to certain conditions, and can be self-managed, with governance carried out by the Board of Directors. In comparison to Registered Alternative Investment Funds, another popular fund structure, AIFLNPs benefit from lower minimum capital requirements and fewer restrictions on investment strategies, making them

particularly appealing to investors seeking to engage with emerging asset classes like crypto-assets.

ALIGNMENT WITH EU REGULATORY FRAMEWORK

Cyprus is aligning itself with the evolving EU regulatory framework, making notable progress in creating a legal environment that accommodates blockchain and cryptocurrency businesses. **A significant development is the transposition of the AMLD5 into Cyprus law in February 2021, which extended anti-money laundering (AML) obligations to crypto exchanges and wallet providers.** This development was an important first step in regulating crypto-assets, establishing a foundation for compliance that safeguards investors and ensures financial transparency, that can be expected to eliminate the doubts of centralised financial institutions around crypto-asset investments.

Meanwhile, the recently adopted Markets in Crypto-Assets Regulation (MiCAR) is poised to transform the licensing, operation, and supervision of funds and crypto-asset transactions across the EU. Cyprus will undoubtedly transpose the legislation into national law, further eliminating business uncertainty around crypto-asset transactions. This will enable Cyprus to adopt blockchain and crypto-asset practices in a structured manner, leveraging the country's existing expertise in investments in crypto-assets, blockchain, DLT and other emerging technologies.

Although Cyprus currently has not adopted a comprehensive national regulatory framework for digital assets, its commitment to EU compliance ensures that MiCAR will establish clear guidelines for the treatment and regulation of digital assets in the country. This alignment with EU regulations will allow Cyprus-based funds and other businesses to benefit from EU passporting rights, enabling them to operate

³ <https://www.cysec.gov.cy/en-GB/entities/regulatory-sandbox-existing/>

seamlessly across member states, which could further enhance the attractiveness of the Cypriot market for blockchain and crypto-asset structures.

CURRENT STATUS & WAY FORWARD

Currently, the local industry is actively exploring applications of blockchain technology, with pilot projects being implemented in financial services and other industries. The Cyprus government supports blockchain through R&D and public tender opportunities, whilst pilot programmes adopting blockchain for validation of academic titles, transferability of numbers in telecommunications and decentralised platforms in the maritime industry have proven the unparalleled value of the adoption of blockchain and DLT in the market.

As the horizon spans wide in the adoption of emerging technologies, Cyprus has made commendable progress in fostering a favourable environment for blockchain innovation, but faces stiff competition from established blockchain hubs. The country's relatively small size and limited resources make it challenging to claim a leadership role in the global blockchain market. However, Cyprus is well-positioned to carve out a niche, particularly in areas where regulation and innovation intersect. **By aligning its national laws with MiCAR, Cyprus can create a stable and trusted regulatory environment, attracting companies interested in developing blockchain solutions within the European market. To remain competitive, Cyprus must continue to refine its legal framework, particularly regarding taxation and cross-border compliance.** Expanding the scope of regulatory initiatives like the Regulatory Sandbox and offering blockchain-specific tax incentives could further attract investment in the sector. Further involvement of additional regulatory authorities, such as the Central Bank of Cyprus in recognising and/or accepting digital assets would set the basis

for groundbreaking developments in the payments and banking sector.

Overall, blockchain in Cyprus has started to be a recognised technology solution and the legal framework developed around it is also starting to reflect that. Businesses should start preparing now for the implementation of MiCAR and potential changes to the taxation of digital assets. **Collaborating with legal advisors and leveraging resources like the Regulatory Sandbox Hub will be crucial in launching new businesses, staying ahead of competition while ensuring compliance.** Businesses engaged in emerging technologies such as DeFi and NFTs could even take advantage of the Sandbox to test and refine their projects under regulatory supervision. With continued commitment to regulatory clarity, innovation support, and cross-border compliance, Cyprus has the potential to solidify its role as a key player in the European blockchain landscape, driving both economic growth and technological advancement.

REGULATING A BORDERLESS INDUSTRY - CHALLENGES AND A PATH FORWARD FOR CRYPTOASSET MARKETS¹



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BORDERLESS FINANCIAL MARKETS - CHALLENGING TRADITIONAL REGULATORY STRUCTURES

The inherently borderless nature of the cryptoasset industry continues to challenge traditional financial regulation paradigms. Publicly-traded cryptoassets can exist on decentralised networks without any anchor to a centralised authority, while consumers are often able to participate in cryptoasset markets from anywhere in the world.

While the borderless structure of these markets can improve liquidity and transparency for consumers, high profile collapses of cryptoasset businesses have increased regulatory scrutiny. National

licensing regimes for cryptoasset businesses are emerging globally, with aims focused on protecting consumers and markets while supporting risk-appropriate innovation.

Despite these efforts, there is a growing risk that national regulators' attempts to provide clarity will create a patchwork of requirements that becomes increasingly difficult for international businesses to navigate. Industry participants have raised concerns about a potential "fragmented landscape"² in which the international market for cryptoassets sub-divides into numerous domestic sub-markets fenced off by unique and potentially incompatible regulatory environments. Amongst other dangers, this would severely hamper liquidity in markets and decentralisation of networks.

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² Riezman J, *The Unintended Consequences of FIT21's Crypto Market Structure Bill*, 24 May 2024, available at <https://www.coindesk.com/opinion/2024/05/24/the-unintended-consequences-of-fit21s-crypto-market-structure-bill/>

While jurisdictions may want to take a protectionist approach by enforcing strict jurisdiction-based regulatory boundaries to claim a bigger piece of the proverbial pie, there is a real risk that such an approach will harm the market overall by reducing liquidity and consumer choice. On the other hand, if jurisdictions adopt an open yet responsible attitude towards international businesses, the global cryptoasset market can become more robust and efficient.

It is therefore important that regulators consider the international aspects of their regimes. Many of these issues around market access will be familiar from the TradFi space, albeit crypto's borderless nature raises novel angles. How should regulators define the territorial scope of their regimes, particularly where value chains are complex and geographically dispersed? What conditions and safeguards are needed to allow market access by non-domestic firms whilst still ensuring adequate consumer protection, market integrity and financial stability in the markets for which they are responsible? How can local firms be protected from unfair competition from overseas firms that are subject to lower (or no) standards?³

In this article, we consider the approach taken to cross border market access in a sample of key jurisdictions and the issues that have arisen with them. We also propose a set of principles to support regulatory policy development in this area.

1. FINDING COMMON GROUND: INTERNATIONAL STANDARDS AND RECOMMENDATIONS

International standard setting bodies such as the Financial Stability Board and the Board of the International Organization of Securities Commission have been doing commendable work to promote robust and

³ For example, there may be DEXs offering derivatives or leveraged products implementing little KYC and few controls, allowing access to retail customers from anywhere in the world.

consistent international standards, which we strongly support.⁴

The most detailed cryptoasset international standards are in the AML/CTF area, where the Financial Action Task Force (**FATF**) has issued guidance recommending national regulators impose relevant licensing, registration and supervision requirements on Virtual Asset Service Providers.⁵ As a result, numerous jurisdictions including the EU, UK, USA, Japan, Switzerland, Singapore, UAE, Hong Kong and Australia have to some degree implemented FATF's guidance. This should provide a degree of consistency across jurisdictions that enables regulatory authorities to more confidently and safely allow overseas firms access to their financial systems.

2. MiCA: AN EARLY AND COMPREHENSIVE FRAMEWORK, BUT IS IT A "WALLED GARDEN"?

The Markets in CryptoAssets Regulation (**MiCA**)⁶ states explicitly that "*markets in crypto-assets are global and thus inherently cross-border*"⁷ and that "[t]he lack of an overall Union framework for markets in crypto-assets could also lead to regulatory fragmentation, which would distort competition in the internal market, make it more difficult for crypto-asset service providers to scale up their activities on a cross-border basis and would give rise to regulatory arbitrage".⁸ Accordingly, MiCA's clear policy objective is to create a well-functioning single EU market for cryptoassets, which reflects the EU policy of "Strategic Autonomy".⁹ However, our view is that the policy concerns around market

⁴ See <https://www.fsb.org/uploads/P170723-3.pdf> and <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD747.pdf>

⁵ Capturing exchanges, various payment service providers, wallet providers, custody providers and businesses offering services related to ICOs.

⁶ Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets ("**MiCA**")

⁷ Recital 8, MiCA

⁸ Recital 5, MiCA

⁹ The European Council formulated strategic autonomy in 2016 as "the capacity to act autonomously when and where necessary and with partners wherever possible".

fragmentation at EU level also apply to global cryptoasset markets.

Critically, MiCA does not only regulate EU-based cryptoasset firms, but can also capture non-EU entities that interact with EU markets. For example, stablecoin issuers need to be established in the EU, which is already resulting in a lack of international fungibility for widely traded assets like USDT, which could undermine the benefits of such assets in facilitating cross-border settlement. Non-EU firms subject to MiCA need to operate via EU established and locally regulated entities, which in many cases is driving internationally active firms to duplicate existing structures at EU level. The treatment of third country firms is also less permissive than under MiFID II, creating tension with MiCA's stated philosophy of "same risk, same regulation". In particular, unlike MiFID II, MiCA lacks "equivalence" (mutual recognition) provisions.

MiCA offers a narrow "reverse solicitation" proviso, whereby non-EU firms can provide services to EU clients on the clients' initiative without requiring a licence under MiCA. However, this exemption has been criticised as unduly restrictive.¹⁰ For example, where an EU client solicits a non-EU firm's services, such reverse solicitation exemption only applies to services relating to the same type of cryptoasset and in the context of the original transaction. A strict interpretation of this guidance may disqualify firms from relying on the exemption whenever a blockchain's code is updated, or from being given access to upgrades or improvements to products and services, which could result in consumer detriment. ESMA draft guidance on reverse solicitation also notes that mere participation in road shows, trade fairs and other events can amount to "solicitation", thereby negating the benefit of the reverse solicitation exemption.¹¹ This goes beyond guidance previously provided by ESMA in the context of the reverse solicitation exemption

under MiFID II¹² and may deter international firms from engaging in EU industry and policy initiatives, which risks cutting the EU off from valuable international discussions that are to the benefit of the cryptoasset industry globally.

Overall, MiCA is seen as an encouraging and significant development in international crypto regulation, in particular given its ambitious and comprehensive nature. The limited provisions for market access for non-EU firms perhaps reflect the lack of potentially "equivalent" non-EU jurisdictions currently. It may also reflect a more general move away from equivalence by the EU (beyond the cryptoasset industry) which arguably has been a broader trend over recent years. However, as regulatory frameworks continue to mature globally, this may need to be revisited. Indeed, introducing a mechanism for the EU to grant equivalence under MiCA could incentivise other jurisdictions to follow a similar regulatory approach to the EU, strengthening the EU's position globally and allowing the EU to capitalise on a "first mover advantage". Alternatively, if the EU no longer generally considers equivalence to be a suitable model for granting third country access, alternatives should be considered in order to avoid unnecessary market fragmentation.

3. UNITED KINGDOM: POSITIVE SIGNS OF OPENNESS BUT DEVIL WILL BE IN THE DETAIL

The UK Treasury (**HMT**) has announced its intention to expand the existing financial services regulatory perimeter to capture cryptoasset activity.¹³ Accordingly, engaging in any regulated activities¹⁴ in respect of cryptoassets, by way of business in or to the UK, will require Financial Conduct Authority (**FCA**) authorisation. The addition

¹⁰ See <https://www.gdf.io/wp-content/uploads/2024/04/GDF-MiCA-Reverse-Solicitation-Response-FINAL.pdf>

¹¹ See Para 12, https://www.esma.europa.eu/sites/default/files/2024-01/ESMA35-1872330276-1619_Consultation_Paper_on_the_draft_guidelines_on_reverse_solicitation_under_MiCA.pdf

¹² See https://www.esma.europa.eu/sites/default/files/library/esma35-43-349_mifid_ii_gas_on_investor_protection_topics.pdf

¹³ Part III of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

¹⁴ As defined in the Regulated Activities Order.

of the “or to” aspect in the territorial scope of the regime represents a departure from the usual territorial scope of the UK perimeter for analogous TradFi activities, and HMT has noted that there will need to be “nuances” in applying this general approach to specific activities.¹⁵ Catering for such nuances appropriately (e.g. in the context of institutional trading and DeFi) will be critical to ensuring that the regime operates effectively.

Significantly however, HMT does not currently support expanding the Overseas Person Exception (OPE)¹⁶ to cover cryptoassets, seemingly at odds with the “same risk, same regulation” principle. HMT has not clarified in detail the reasons for the differentiation as yet, beyond stating that the ‘context’ of cryptoasset markets differs from traditional markets.¹⁷ As the details of the UK regime are fleshed out, we would welcome more detailed consideration on whether aspects of the OPE - for example, exemptions for dealing with sophisticated counterparties and reverse solicitation - might be applied to the crypto market, even if HMT does not consider it appropriate to carry across the OPE in its entirety.

Additionally, in considering the issue of access to global order books, HMT has acknowledged¹⁸ the potential for future equivalence type arrangements, but considers that the conditions required for equivalence/deference are not yet present. It is encouraging, however, that HMT has recognised that an interim approach¹⁹ to

15 See Para 4.5, https://assets.publishing.service.gov.uk/media/63d94ea68fa8f51881c99eb4/TR_Privacy_edits_Future_financial_services_regulatory_regime_for_cryptoassets_vP.pdf

16 The OPE is a regulatory exception existing under FSMA which applies to regulated activities carried on in respect of traditional asset classes. It allows for overseas firms to conduct certain regulated activities in the UK in the absence of an FCA licence subject to various conditions depending on the nature of the activity.

17 See Para 4.33, https://assets.publishing.service.gov.uk/media/653bd1a180884d0013f71cca/Future_financial_services_regulatory_regime_for_cryptoassets_RESPONSE.pdf

18 See https://assets.publishing.service.gov.uk/media/653bd1a180884d0013f71cca/Future_financial_services_regulatory_regime_for_cryptoassets_RESPONSE.pdf

19 HMT has signalled that a way of achieving this could be to permit UK firms who are operating a regulated cryptoasset trading venue in an overseas jurisdiction to be able to apply for authorisation for a UK branch extension of their overseas entity. The branch could be authorised to specifically handle trade matching and execution activity.

market access is required to ensure that UK consumers receive satisfactory execution outcomes for cryptoasset orders, stating that “a highly restrictive location and market access policy would be unlikely to achieve this due to limited order book depth (since a UK order would only be able to be matched against another UK order)”.

We strongly support HMT’s pragmatic approach to market access in considering solutions before the conditions for a “full fat” equivalence regime are present. **An open but safe approach to overseas access could, in our view, provide the UK with a significant competitive advantage over other jurisdictions.**

4. THE UNITED STATES: CONTRASTING APPROACHES ACROSS DIFFERENT MARKETS

The aggressive approach adopted by US authorities toward the crypto industry is well-documented. The SEC, CFTC and/or DOJ have threatened or brought high-profile enforcement actions against major firms (and in some cases, their personnel) including Coinbase, Binance, Crypto.com, Kraken, and Ripple. While the outcomes of these actions have varied, the hostile attitude continues to dramatically impact the global market.

There remains significant uncertainty regarding both the circumstances in which the *Howey*²⁰ principles apply to the sale of cryptoassets, and the extra-territorial application of legislation such as the 1933 Act²¹ and the Commodities Exchange Act.²² Even firms that have taken the dramatic step to exit the US entirely face significant complexities. Some lower US courts have held that the simple fact that US-based blockchain nodes may have been involved in verifying a transaction can subject that transaction (and persons involved) to federal securities laws.²³ Other courts have gone further, holding

20 *SEC v. Howey Co.*, 328 U.S. 293 (1946)

21 Securities Act of 1933.

22 Commodities Exchange Act.

23 *In re Tezos Securities Litigation*, 2018 WL 4293341.

that even the possibility of involvement of US-based cloud services may classify a transaction as 'domestic activity', subject to possible SEC or CFTC enforcement action.^{24,25}

The case of SEC v Ripple Labs demonstrates some of the harm that this uncertainty can cause. After the SEC filed its action, major US exchanges delisted XRP, impacting market efficiency and wiping \$15 billion from its market capitalisation. US consumers suffered part of these immediate trading losses. While Judge Torres held that sales of XRP on the secondary market do not constitute 'investment contracts', the secondary market for XRP (and other cryptoassets) continues to face uncertainty in the US.²⁶

In contrast to the deep uncertainty outlined above and the exceptional impacts it continues to have on US consumers and firms, we note that the SEC and CFTC already apply substituted compliance in the traditional finance space. For example, the CFTC recognises²⁷ the comparability of the European Commission's margin rules governing uncleared swaps vis-a-vis the CFTC's own margin rules and permits specified swaps dealers to satisfy certain CFTC requirements via compliance with the EU equivalents.

In the cryptoasset space, SEC Commissioner Peirce has proposed an embryonic form of cross-border cooperation, suggesting that the US join the UK's Digital Securities Sandbox (DSS) to *"allow firms to conduct the same sandbox activities under the same regulatory requirements"*

²⁴ *Williams v. Block One*, 2022 WL 5294189 (S.D.N.Y. Aug. 15, 2022)

²⁵ For further discussion on the issue of geo-fencing and the US courts' application of the principles of extraterritoriality in *Morrison v National Bank of Australia* 561 U.S. 247 (2010), see <https://variant.fund/articles/practical-guide-to-geofencing/>.

²⁶ At the time of writing, Judge Torres' decision that secondary market sales do not constitute investment contracts is subject to appeal by the SEC. Arising out of this appeal, Coinbase has urged an appellate court to grant its request for interlocutory appeal in its own case versus the SEC seeking clarity on the position. Additionally, Crypto.com has been served with a Wells Notice and will sue the SEC and Gary Gensler for alleged regulatory overreach concerning this issue.

²⁷ See <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2017-22616a.pdf>

in both countries.²⁸ This would enable US and UK firms to test uses of distributed ledger technology within financial services infrastructure, and to test changes to regulation before they become permanent. It would be a valuable example of how regulatory sandboxes can facilitate international regulatory collaboration in a low risk environment.

While clarification of the US' federal securities law position is the more urgent need, extending substituted compliance to cryptoasset-related activity would assist with international harmonisation, reduce operational costs, and enhance and encourage cross-border compliance.

5. AN EFFECTIVE CROSS BORDER FRAMEWORK FOR CRYPTOASSETS: KEY FOUNDATIONAL PRINCIPLES

Drawing on many of the emerging practices discussed above, we propose the following set of principles to establish a safe but innovation-friendly cross-border market access framework which reflects the global and borderless nature of cryptoassets.

- **Robust international standards.** Consistent regulatory expectations and standards applied internationally are the cornerstone of any cross-border market access system. A range of international standards applicable to cryptoassets, for example the FATF guidance referred to in Section 2, have already been developed or are in progress and we strongly support this work. **It is important not to wait for a panacea where appropriate international standards exist across the board - these will take time to develop and mature, and will continue to evolve over time.** Where standards are already sufficiently developed in a particular area (e.g. AML/CTF),

²⁸ Peirce, H, Comment on Digital Securities Sandbox Joint Bank of England and Financial Conduct Authority Consultation Paper, 29 May 2024, available at <https://www.sec.gov/newsroom/speeches-statements/peirce-boe-fca-comment-05302024>

consideration should be given to how cross-border access can be improved as a result in that limited area.

- **Proportionality.** Different firms with varying business models pose different levels and types of risk - this applies to both domestic and international firms providing services on a cross-border basis. While regulators across the world have been “scarred” by various well-documented failures that have resulted in significant consumer harm, care needs to be taken to avoid applying across-the-board standards that are really only appropriate for firms with the greatest potential to cause harm. There should, for example, be appropriate differentiation between retail and wholesale firms, and appropriate oversight according to the size of a firm’s business in the relevant jurisdiction. There can sometimes be a tendency to view all crypto activity as inherently high-risk, resulting in well established proportionate approaches from TradFi (e.g. the OPE) not being carried across. These sort of blanket assumptions should be avoided, and a nuanced and risk-based approach should be maintained.
- **Deference.** Where possible, regulatory authorities should consider cross-border cooperation and be prepared to defer to the approaches taken in other jurisdictions where these are sufficiently robust. While a full “equivalence” regime (the granting of market access to firms from equivalent jurisdictions) may not yet be possible in crypto due to the industry’s nascent stage, deference does not need to be “all or nothing”. **Even in the absence of market access deference provisions, substituted compliance style arrangements in respect of particular areas of regulation would be enormously beneficial for international groups who could then align to a single standard across multiple geographies.** Interim arrangements - similar to those being considered by the UK, as noted above - should also be considered, in order to prevent damaging market

fragmentation while global regulatory standards continue to evolve.

- **Flexibility.** As discussed, the crypto industry is nascent and unique. Regulatory frameworks need to be flexible enough to accommodate multiple business models and structures. Regulatory authorities should prescribe outcomes and the onus should then be on firms to demonstrate how their group structures meet these standards. When assessing whether the required outcomes are met, regulators should consider how being part of a larger, well-resourced international group can strengthen a firm’s ability to manage risk effectively.
- **Regulatory clarity on territorial scope.** Given the complexities of cross-border service provision, and the often unclear application of existing TradFi principles to the crypto space, regulatory authorities should continue developing guidance on how to interpret the territorial scope of their regimes in a crypto context. Procedures such as “no action” letters are particularly helpful, as they provide clarity to recipient firms and, when published as precedents, benefit the broader industry.

CONCLUSION

Insular and protectionist regulation will ultimately have a counterproductive effect, freezing and fragmenting markets and encouraging regulatory arbitrage and illicit cross-border activity outside the umbrella of regulated environments.

As regulators show encouraging signs of meaningful and productive engagement with the crypto industry (and one another), there is an opportunity to develop frameworks that both protect consumers and reflect the borderless nature of crypto markets. Establishing clear, pragmatic rules for overseas market access will facilitate integrated, efficient and safe global markets for cryptoassets. We see positive signs in this regard, though there is a long road ahead.

ARTICLE V



A BRIEF LEGAL TOUR OF INITIAL EXCHANGE OFFERINGS (IEO) IN MALAYSIA



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An Initial Exchange Offering (IEO) is a permutation of the Initial Coin Offering (ICO), where an issuer mints new digital tokens and sells them directly to investors to raise funds. Typically, after an ICO, the tokens are listed on a digital asset exchange (DAX) for public trading.

Unlike an ICO, which is offered straight to the public, the IEO exercise is conducted through a DAX platform. The tokens are sold to investors for the first time upon listing and openly traded on the DAX. In other words, both the primary market for initial offering and secondary market for subsequent trading are essentially collapsed into one, and facilitated by the same intermediary.

Issuers prefer the IEO option due to the large established user base of a DAX, which provides a ready market to place out the tokens. It is also more efficient for a DAX to onboard and document investors than for issuers to manage this themselves. However, there are concerns regarding potential conflicts of interest as the DAX assumes multiple roles including deal arrangement,

promotion, distribution, and market making. It is crucial for both issuers and investors to be aware of the dynamics and risks associated with IEOs, which are often not adequately mitigated or made transparent.

DOMESTIC REGISTRATION

Malaysia introduced its *Guidelines of Digital Assets* to regulate IEO in January 2020¹, following the prohibition of all unauthorized ICO activities the year before. Those caught violating this would face up to a 10-year jail sentence and RM10 million fine, which is of similar gravity to conventional capital market offenses involving securities and futures contracts.²

The country's Securities Commission is tasked as the main regulatory body for IEO, with the objective to create an alternative funding mechanism for early-stage tech

¹ See [Digital Assets - Guidelines | Securities Commission Malaysia](#)

² For instance, sections 182 and 209 of the *Capital Markets and Services Act 2007*.

enterprises and small-to-medium sized companies with innovative value propositions. It has classified IEO as a “recognized market” (which entails less stringent regulation than a normal “approved market”) and registered two operators to conduct IEO campaigns responsibly.

Emphasis must be made that while the IEOs in the Malaysian context share a similar purpose with conventional IEOs, they differ in legal character and process. There is a clear separation of roles between the primary and secondary market operators.

Issuers must comply with local corporate registration requirements as legal entities, in the form of a limited liability company (LLC) or limited liability partnership (LLP). Historically for ICO, private foundations were the vehicles of choice and have been used by major blockchains such as Ethereum, Solana and Cardano. Nowadays, decentralized autonomous organizations (DAO) have gained popularity instead. There is no explicit prohibition against them so long as they are legally wrapped in an LLC or LLP.

Equally important are the Board of Directors of the issuer, whose members must be held “fit and proper” at all times, with at least two of them domiciled in Malaysia. To ensure direct accountability, the directors and senior management must collectively hold majority equity interest in the company, with a moratorium imposed on their shares until all deliverables (as promised in the IEO whitepaper) are completed. However, there is no mandatory lock-up period for their token holdings, which are non-dilutive to equity.

PRESCRIPTION OF SECURITIES

Malaysia adopts an inclusive approach to the legal characterization of digital assets. The main reference point is a piece of regulation, commonly referred to as the *Prescription of Securities Order 2019*, which distinguishes between digital currencies and digital tokens.

Under this, digital tokens that are issued for the purpose of an IEO are generally prescribed as securities when:³

- a. The tokens are bought or exchanged for consideration;
- b. Monies from the sale of tokens and income are pooled;
- c. Income or returns are generated from the arrangement;
- d. Buyers expect return or appreciation in value of tokens;
- e. Buyers have no day-to-day control of the arrangement; and
- f. The tokens are not issued by any government body.

Although contemporary literature tends to construct a dichotomy between security tokens and utility tokens, the latter is not specifically defined in Malaysia. **If utility tokens are created for fundraising, they will be prescribed as securities and governed by securities laws just the same.** For instance, tokens structured for recreation (play-to-earn), or governance (voting), or purely as memes – and are undertaken as part of an IEO – will still be regulated by the *Guidelines of Digital Assets*. It is not further stated whether an exemption or safe harbor applies for token funding based on non-commercial or non-profit purposes, or done through private means.

In the absence of a clear taxonomy, the new and popular breeds of asset-referenced stablecoins and non-fungible tokens (NFT) with composite product features must be evaluated on a case-by-case basis. This approach is not in derogation of other securities laws, and necessarily takes into account all applicable laws related to payment services, foreign exchange administration, interest schemes, digital signature, multimedia communication, asset recovery, and more. The *Guidelines* are notably silent on the scope and applicability of fiduciary duties.

³ Section 3(2)(a)-(e) of the *Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019* (P.U.(A) 12/2019).

Despite the growing legal recognition of digital assets as a form of 'property' by many jurisdictions, including Common Law ones, there is no *stare decisis* or legislative framework on this yet in Malaysia.⁴ Nevertheless, digital tokens from an IEO are stored and held on trust for investors by licensed crypto custodians. And for the purpose of taxation, digital assets are already treated as either capital or revenue assets by the country's Inland Revenue Board.⁵

SHARIAH COMPLIANCE

Malaysia ranks first in the Islamic Finance Development Index as the "most developed country in Islamic Finance" (surpassing Saudi Arabia and Indonesia),⁶ and dominates the global *sukuk* (shariah-compliant bonds) market.⁷ It also lays claim to the world's first tokenized *sukuk* linked to a sovereign instrument.⁸

The Shariah Advisory Council (SAC) of the Securities Commission has taken a progressive stand on the capital market activities involving digital assets. Digital tokens are recognized as '*mal*' (assets) under the category of '*urudh*' (goods) from a Shariah perspective. The rights and benefits attached to the digital token, as well as the utilization of proceeds from the token issuance, will determine its Shariah-compliant status.⁹

Within Malaysia itself where the SAC has jurisdiction, the investment and trading of digital tokens on the registered digital asset exchanges have been deemed "permissible" since July 2020. The act of 'burning' (or destruction) of such tokens for price stabilization within certain limits is also allowed.¹⁰

4 Edmund Yong, "Digital Assets Are Not Your Property, Strictly Speaking", *The Edge*, 23 September 2024.

5 *Guidelines on Tax Treatment of Digital Currency Transactions* (LHDN.AG.600-1/7/3).

6 ICD-Refinitiv, *Islamic Finance Development Indicator Report 2022*, pp. 10-12.

7 Ministry of Finance (Malaysia), "MIFC's Role Vital to Drive Islamic Finance Growth", 29 November 2023.

8 Bernama, "World's First Institutional Tokenized Sukuk Backed by a Sovereign Linked Instrument Listed", 30 October 2023.

9 Securities Commission (Malaysia), *233rd & 234th Shariah Advisory Council Meeting*, 20 July 2020.

10 Securities Commission (Malaysia), *274th Shariah Advisory Council Meeting*, 16 November 2023.

MID-SHORE JURISDICTION

There is an adjacent regulatory framework for digital tokens in Labuan, a federal territory of Malaysia that serves as a mid-shore destination for international companies. It is maintained by the Labuan Financial Services Authority, a statutory body under the purview of the country's Ministry of Finance.

The *Guidelines on Labuan Securities Token Offering* (STO) were launched in January 2023. The main areas which differ from its onshore IEO counterpart are the latitude given to secondary listing rules and private placements (which only require notification to the regulator rather than approval), as well as sharper clarity on tokenizable securities (which includes shares, debentures, mutual funds, units and interests) and their use for borrowing and lending.

For instance, Real Estate Investment Trusts (REIT) fall under the definition of securities according to Labuan laws whereas NFT formats *prima facie* do not.¹¹ Utility tokens are treated as 'non-securities' therein. Rather, they can be issued as 'credit tokens' which are not deemed as securities – so long as they are "not unlawful, immoral, or contrary to any public policy in Malaysia".¹²

ASSET TOKENIZATION

In all fairness, asset tokenization in a regulated setting is still in its infant stages. It is used primarily as a tool for capital formation and has embarked on new directions such as corporate bonds and social enterprises. The public-private partnership for Malaysia's national Layer 1 public blockchain, which serves as a platform for cross-border supply chain and trade financing, was partly funded by an IEO.¹³

11 Labuan Financial Services Authority (Malaysia), *Frequently Asked Questions: Guidelines on Labuan Securities Token Offering*, 9 October 2023.

12 Labuan Financial Services Authority (Malaysia), *Guidelines on Credit Token Business*, 26 June 2024.

13 Adam Aziz, *MyEG's Blockchain Infra Zetrix to Issue Cryptocurrency via Initial Exchange Offering*, *The Edge*, 17 October 2023.

Issuers have to consider legal nuances as the smart contract for a Malaysian IEO is kept as a perfunctory record-keeping device. For instance, funds are raised and settled in the form of cash, not cryptocurrencies. Investors have a compulsory cooling-off period for any change of mind, hence the usage of smart contracts to automate the synchronous transfer of funds and distribution of tokens would not be practical. Moreover, there is no regulatory stipulation for institutional-grade security token standards (such as ERC1400 and ERC3643). Common standards with bearer instrument features (such as ERC20) are being used for IEOs, which may not be sufficiently compliant for the tokenization of real world assets.

As more complex product proposals proliferate in the market, e.g. with staking and rehypothecation features, the IEO mechanism will eventually have to adapt. A useful approach for lawyers faced with the dearth of precedent is to focus on 'substance over form'. They should look past the technical jargon as the underlying features are familiar and fall back on conventional securities laws.

REGULATIVE OUTLOOK

A sandbox has recently been outlined to cultivate innovative tokenized offerings that do not fit within the existing regulatory framework.¹⁴ Beyond that, regulations will be much needed to encompass the full lifecycle of digital tokens and post-trade asset servicing infrastructure.

The current global trend favors tighter accountability and wider investor protection. **New technology brings along new risks which most investors do not understand even with a disclosure-based regime in place.** Therefore, while regulators try to stay tech-neutral, they cannot ignore the new risk exposures. The legal community must remain cognizant of the policy balancing act even as clients demand that they tap the full potential of this technology.

¹⁴ Securities Commission (Malaysia), [Media Release: SC Unveils Three Initiatives to Spur Innovation](#), 1 October 2024.

COMPARATIVE OVERVIEW OF ICO, IEO AND STO

Type of Financing	Initial Coin Offering (Conventional)	Initial Exchange Offering (Malaysia)	Security Token Offering (Labuan)
Addressable Segment	Popularized by projects based on blockchain without financial track record; and adopted as early stage financing for micro/small/medium sized enterprises. ¹⁵	Projects that provide an “innovative solution or digital value proposition for Malaysia”, embarked by companies during their indicative early and growth cycles. ¹⁶	Fintech-related projects including “digital innovations to transform business” by companies based in the Labuan International Business and Financial Centre. ¹⁷
Regulatory Oversight	None or unclear. In its original state, no registration and disclosure requirements were observed before and after the offering.	Securities Commission (SC) of Malaysia has instituted a ‘recognized market’ for IEOs. Digital tokens are legally prescribed as securities.	Labuan Financial Services Authority (LFSA) regulates conventional securities that are tokenized and recorded on blockchain.
Investment Restrictions	Generally open to all investors (mostly retail), without any customer profiling, background checks or whitelisting.	Limits set on fundraising quantum by issuer and on respective investor class i.e. sophisticated, angel and retail.	Different rules apply depending on whether the STO qualifies as a private placement or public offering.

¹⁵ OECD, Initial Coin Offerings (ICO) for SME Financing, 2019.

¹⁶ Securities Commission (Malaysia), [Capital Market Masterplan 3 \(2021 to 2025\)](#), Ch. 3.

¹⁷ Labuan Financial Services Authority (Malaysia), [Guidelines on Labuan Security Token Offerings](#), 6 October 2023.

THE FUTURE OF GLOBAL INFORMATION REPORTING FOR DIGITAL ASSETS: UNPACKING THE OECD'S CRYPTO-ASSET REPORTING FRAMEWORK (CARF) AND CRS AMENDMENTS



MAX BERNT
MANAGING DIRECTOR FOR EUROPE
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INTRODUCTION: FROM WILD WEST TO REGULATED MARKETS

For years, the world of digital assets has been viewed as the “Wild West” of finance.¹ Emerging in the aftermath of the global financial crisis, digital assets like Bitcoin offered a decentralized and largely unregulated space where innovation could flourish free from government intervention. However, as with any evolving landscape, regulatory structures are beginning to take shape.

Given the growing focus on the illicit use of crypto-assets in their early stages, it was not surprising that the Financial Action Task Force (FATF) was among the first international standard-setting bodies

¹ In the experience of the author, the term ‘digital asset’ has become the predominant term for the broad spectrum of assets that refer to a digital representation of value based on a cryptographically secured distributed ledger or similar technology to validate and secure transactions, including, but not limited to, crypto-assets (such as BTC and ETH), stablecoins, and tokenized financial instruments and assets. On the other hand, the use of the term ‘cryptocurrency’ is no longer common among experts.

to lead harmonization efforts, particularly in the areas of AML/CFT. However, as institutional adoption grows by the day, tax administrations have also become aware of the significant amounts of untaxed funds circulating in this space. Taking the lead in addressing these concerns is the Organisation for Economic Co-operation and Development (OECD), with the introduction of its Crypto-Asset Reporting Framework (CARF). Adopted in 2023 and supported by amendments to the Common Reporting Standard (CRS), CARF represents a global effort to bring the crypto-asset industry under a cohesive international tax reporting regime.² While some jurisdictions may find the CARF rules aligned with existing practices, others might implement stricter standards or have already done so.

But before concerns about increased regulation arise, it is crucial to understand the rationale behind these changes and their implications for both businesses and

² OECD (2023), *International Standards for Automatic Exchange of Information in Tax Matters: Crypto-Asset Reporting Framework and 2023 update to the Common Reporting Standard*, in: OECD Publishing, Paris, <https://doi.org/10.1787/896d79d1-en>.

individuals involved in digital assets. This article provides an overview of CARF's key components, explores the latest OECD updates, and explains how this new regime might affect everything from internal compliance procedures to the way we think about decentralized finance (DeFi) regulation.

CARF: A NEW FRONTIER FOR DIGITAL ASSET REPORTING

The Crypto-Asset Reporting Framework (CARF) is designed to extend the transparency already present in traditional finance to the growing digital asset market. Endorsed by the G20 and supported by over 60 participating jurisdictions, it establishes a standardized approach for the institutional reporting of customer-related crypto-asset activities to local tax administrations, as well as the subsequent automatic cross-border exchange of information between participating countries.

More specifically, the framework defines "Crypto-Asset" broadly, covering payment tokens (e.g., Bitcoin, Ether), asset-referenced tokens, equity/debt tokens (such as equity shares or bonds), and certain NFTs. These assets are characterized by their ability to be held and transferred in a decentralized manner, without the involvement of traditional financial intermediaries. Notably, Central Bank Digital Currencies (CBDCs) and Specified Electronic Money Products, which represent a claim on an issuing central bank and/or have a stable value tied to a single fiat currency, fall under the CRS framework rather than CARF.

Overall, CARF operates on a two-tier approach: (i) service providers report crypto transactions of their users to tax authorities, and (ii) this information is exchanged across jurisdictions to ensure transparency. **Importantly, CARF does not impose new rules on the taxation of crypto-assets themselves, nor does it dictate how service providers' profits are taxed. Instead, its focus is on providing tax authorities with the necessary**

information to monitor and assess the tax consequences of crypto-asset transactions, creating a harmonized cross-border reporting framework.

Before CARF, tax authorities had limited visibility into crypto transactions, leaving a significant gap in global tax compliance. While some jurisdictions had implemented their own regulations, CARF represents the first unified international initiative aimed at addressing the crypto tax gap. In essence, it functions as a global data-sharing system, similar to the CRS for financial accounts, allowing tax authorities to track crypto transactions and ensure proper tax reporting. In today's environment, where tax revenues are critical, governments can no longer permit crypto-assets to operate outside the regulatory framework.

KEY FEATURES OF CARF

Under CARF, *Reporting Crypto-Asset Service Providers (RCASPs)* — such as exchanges and pretty much anyone controlling platforms facilitating relevant crypto transactions — are required to collect detailed information about their customers through a self-certification process. This includes obtaining Tax Identification Numbers (TINs) and applying these procedures to both new and existing customers. The need for re-certification has been a subject of debate, particularly due to the potential costs involved in applying these measures.

As for what RCASPs are required to report, CARF covers four main types of (domestic and cross-border) reportable transactions: i) exchanges between reportable crypto-assets and fiat (i.e., Buy/Sell); ii) exchanges between one or more reportable crypto-assets (i.e., trading); iii) transfers of reportable crypto-assets (i.e., transactions leaving a platform, for example to a cold wallet); and iv) high-value retail payment transactions (i.e., transfers for goods or services for a value exceeding USD 50,000 or the equivalent amount in any other currency).

RCASPs need to report annually on an aggregate basis by type of crypto-asset and distinguishing outward and

inward transactions. To improve the usability of this reported data for competent authorities, a distinction is further to be made between crypto-to-crypto and crypto-to-fiat transactions.

From a practical point of view, this seems reasonable, especially considering that in some jurisdictions crypto-to-crypto transactions are a taxable event, while in others they are not.³ However, while the final reporting is thus only required on an aggregate basis, RCASPs will still need to implement transaction-level tracking to be able to fully comply with their due diligence requirements.

Regarding the specific information to be reported, for crypto-to-fiat transactions, the total fiat amount received or paid should be reported as either the acquisition cost or gross proceeds, based on the market value at the time of the transaction. In the case of crypto-to-crypto transactions, the value of the crypto-asset at acquisition and the gross proceeds upon disposal should be reported in fiat currency, according to its fair market value at the time. In both scenarios, RCASPs are required to provide aggregated numbers for units transferred and reportable transactions. Additionally, where possible, RCASPs should categorize transfers by their nature (e.g., staking rewards, airdrops, etc.).

Furthermore, for reportable retail payment transactions and transfers to distributed ledger addresses not known to be associated with a RCASP or Reporting Financial Institutions (RFIs) (e.g., transfers to self-hosed wallets or addresses), each RCASP shall report the number of such transactions as well as their aggregate fair market value and the aggregated number of transferred units.⁴

Finally, to not have tax administrations states unnecessarily burdened with different reporting forms for each jurisdiction, the

³ See, for example, in the context of the European Union's regional implementation directive of CARF, the so-called 'DAC8', in more detail, at: Bernt, M. (2023), DAC8: Commentary on the European Union's New Crypto Tax Reporting Regime, in: European Taxation 2023 (Volume 63), No. 9, <https://doi.org/10.59403/1cqwag>.

⁴ Id. Also here, DAC8 is in line with CARF.

OECD recently released an XML Schema that standardizes how these transactions should be recorded and submitted (including a list of the relevant transfer types). While the XML Schemas is primarily designed to support the automatic exchange of information between tax authorities, jurisdictions can also mandate the use of the XML Schemas for domestic reporting by RCASPs and RFIs, respectively. Jurisdictions are likely to do so, just as they imposed mandates as part of the CRS implementation process.

WHAT ABOUT DECENTRALIZED FINANCE?

The inclusion of non-custodial services, particularly decentralized platforms, has been one of the most debated aspects of CARF. True DeFi—where no single entity has control over the protocol—should remain outside the scope of CARF. However, platforms that offer any facilitation for trading may still be subject to its reporting requirements. The OECD has clarified that even platforms operating in decentralized environments may qualify as RCASPs if they “make available a trading platform” over which they exercise “sufficient influence or control.” This dispels the notion that decentralization automatically equates to deregulation.

CRS AMENDMENTS: BRINGING CRYPTO INTO THE FOLD

While CARF is a new framework, the amendments to the Common Reporting Standard (CRS) are equally important. Since its inception, the CRS has been a cornerstone of global tax compliance, ensuring the automatic exchange of financial account information across jurisdictions. The recent amendments bring crypto-assets under the CRS umbrella, meaning that crypto-assets will now be scrutinized with the same rigor as traditional financial assets like stocks, bonds, and bank accounts.

One of the most notable changes in the CRS amendments is the inclusion of crypto-asset holdings. This was an inevitable step, as

digital assets are increasingly being adopted by mainstream financial institutions, and their treatment under the CRS ensures that tax authorities will have a complete picture of a taxpayer's overall asset holdings. **By aligning CRS with CARF, authorities can better track a taxpayer's full financial profile, leaving fewer opportunities for underreporting or evasion.**

As CARF and CRS overlap in certain areas — such as in reporting structures and data exchanges — the practical effect will be a more unified approach to the reporting of both traditional and digital assets, easing the compliance burden for multi-asset platforms. However, as emphasised in recent discussions between the public and private sectors, there are still certain areas that are unclear and could lead to duplicate reporting obligations. The OECD confirmed that this will be addressed in more detail in the final FAQs.

WHAT DOES THIS MEAN FOR THE INDUSTRY?

For businesses and individuals in the digital asset space, the introduction of CARF and the amendments to the CRS represent a fundamental shift in the regulatory landscape. **The era of crypto-assets operating under minimal regulatory scrutiny is coming to an end, and compliance is becoming a non-negotiable requirement.**

RCASPs and RFIs will be among the most affected, as they will need to overhaul their reporting systems to comply with both frameworks. Early preparation for re-certification of customer data and ensuring systems can accommodate the CARF XML schema will be essential.

A critical feature of CARF is the introduction of Transfer Type categories, which include categories like income from mining, staking, or airdrops. This categorization of crypto transactions will make it easier for tax authorities to assess which activities are taxable, marking a formal

recognition of previously ambiguous crypto-economic activities.

LOOKING AHEAD: THE FUTURE OF GLOBAL CRYPTO COMPLIANCE

The next few years will be critical for both tax administrations and RCASPs/RFIs as they not only prepare for the full implementation of CARF and the amended CRS, but also for (more or less) deviating regional implementation laws. While CARF's first reporting exchanges are expected to start in 2026, the work for RCASPs/RFIs begins now. They will need to adapt to new compliance procedures, ensure they can report in the right schema format, and understand the complex categorization of different crypto transactions.

On top of that, one should keep an eye on the evolving landscape of decentralized finance regulation. True DeFi platforms—those that operate autonomously—may avoid direct reporting obligations under CARF, but hybrid models or non-custodial exchanges with any level of facilitation could be subject to regulation.

Ultimately, the OECD's Crypto-Asset Reporting Framework represents a pivotal moment in the global governance of digital assets from a tax compliance perspective. **By integrating crypto-assets into a similar and partly identical reporting system to that used for traditional financial instruments, the OECD is signaling that crypto is no longer on the fringes of the financial system but a fully recognized and regulated asset class.** While CARF is not intended as a tool for calculating crypto tax liabilities, it will play a crucial role in supporting tax administrations globally by providing a powerful mechanism for risk assessment and data-driven enforcement. This framework will enhance their ability to identify high-risk cases and potential tax evasion ('identifying the big fish'), which in turn, could fundamentally reshape how criminal investigations are initiated and conducted in the digital asset space.

ARTICLE VII



CRYPTO FIRE SALES: A PRIMER ON CRYPTO BANKRUPTCY AUCTIONS AND TRANSACTIONS



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Buying distressed assets is common, but the bankruptcy of major retail crypto companies has led to unprecedented regulatory scrutiny. The Securities and Exchange Commission (“SEC”) and other regulators have weighed in on every crypto bankruptcy transaction, with some cases litigated to determine the legality of the sales. The complexity of these crypto bankruptcy transactions requires a three pronged approach: (1) executing auction procedures and sales processes that will pass muster with the Bankruptcy Court and avoid objections from regulators and creditor groups; (2) contract drafting that accounts for the variables and the significant price impact a short delay could have on distressed crypto assets; and (3) coming up with unique regulatory structures which will not run afoul of the complex web of state and federal crypto regulatory issues and, perhaps most importantly, interfacing with the relevant regulators to avoid drawn out and expensive litigation.

I. BANKRUPTCY ASSET SALES EXAMPLES

Bankrupt crypto estates have sold distressed assets in a variety of ways. The most common are auctions (i.e., where assets are sold to the highest bidder), one-off direct sales (i.e., direct sale of specific assets – usually – to a single buyer), and sales in connection with settling disputes between the estate and a third party entity which would be the subject of a Federal Rule of Bankruptcy Procedure 9019 motion.

To initiate an auction, a motion must be filed with a declaration from an investment banker, followed by potential buyers reviewing assets, bidding, and closing with the highest bid, which is then negotiated and included in a bankruptcy plan requiring court approval to ensure all legal requirements and creditor interests are met before

completion. To engage in a one-off direct sale, a bankruptcy estate must file a motion with the court, provide notice and hold a hearing, obtain court approval, and finalize the sale, which can be quicker than an auction but may not achieve the highest price due to the lack of competitive bidding. Sales in connection with a potential or actual litigation against a third party are subject to Rule 9019 of the Federal Rules of Bankruptcy Procedure. In all cases, there is an opportunity to object from the U.S. trustee, creditors groups like the official committee of unsecured creditors, and individual creditors. Avoiding those objections can result in significant cost savings for the estate.

Auction Example. In connection with the bankruptcy of the retail crypto “broker” platform Voyager, the estate sought to engage in a transaction with a crypto exchange to handle the very difficult and expensive distribution process. This was important because the Voyager estate intended to provide “in kind” crypto distributions to its creditors which requires significant technical and administrative support.

Voyager ran two auctions. The first was one by the infamous FTX crypto exchange which was unable to consummate the deal after filing for bankruptcy itself. Voyager ran a second auction process which was won by BAM Trading Services Inc. d/b/a Binance.us (“Binance.US”). In connection with the deal with Binance.US, the Voyager estate would receive a large cash payment but would also be able to offload all of the administrative and technical expense of distributing crypto to its creditors to Binance.US. The expert investment bankers and financial advisers estimated that the deal with Binance.US would derive approximately \$100M of assets to the Voyager estate. The proposed plan of reorganization for Voyager contained the approval of the Binance.US deal along with a “toggle” which permitted the Voyager estate to distribute assets itself to the extent the Binance.US deal fell through.

The SEC and other regulators objected to the Voyager plan with a particular emphasis on the Binance.US deal. The SEC claimed that the Voyager plan did not comply with existing law and that Binance.US was not in compliance with various securities laws. SEC staff argued that Binance.US was operating an “unregistered securities exchange,” but despite the SEC’s attorneys’ protestations, Judge Wiles ruled not to delay the deal because the “SEC did not actually take the position that Binance.US is operating as an unregistered and unlicensed securities broker” and only “suggested that the Debtors had the burden to prove the negative without offering any evidence,” thus he was not willing to block the plan’s approval on such illusory grounds.¹ Judge Wiles even criticized the SEC for “[c]om[ing] here and tell[ing] me that you don’t have any idea, but that I should stop everybody in their tracks because you might have an issue that you haven’t gotten around to looking at” in connection with what Judge Wiles referred to as “kind of a weird objection.”² Judge Wiles further stated that: “The Bankruptcy Code doesn’t contemplate an endless period of time, things have to be done. We have creditors who are waiting and who, in the midst of all this uncertainty, have no access to property in which they’ve invested, in some case, their life savings.”³ Ultimately, Judge Wiles refused to “put everything on pause just because we don’t know for sure how regulators will eventually make up their minds on points they seem to have been debating for years.”⁴

Following approval, Binance.US backed out in April 2023 citing a “hostile and uncertain regulatory climate.”⁵ The Voyager estate, however, via its public Twitter, noted that the approved liquidation plan had anticipated this potential failed sale and

1 *Voyager* March 7, 2023, bench ruling and confirmation transcripts, page 44 lines 23-25.

2 *Voyager* March 2, 2023, confirmation transcripts, page 25 lines 8-12.

3 *Voyager* March 6, 2023, confirmation transcripts, page 71 lines 7-12.

4 *Id.*, lines 14-17.

5 *Voyager* Docket No. 1345 (Bankr. S.D.N.Y. April 25, 2023) (notice of receipt of termination Notice from Binance.US).

allowed for the estate to “return value to customers via direct distribution,” thereby assuming the distribution obligations.⁶

One-Off Sale Example. One-off sales are often used to add additional value via liquidations of different debtor assets. In SafeMoon US LLC’s (“SafeMoon”) Chapter 7 bankruptcy, the motion for approval of the private sale broke the debtor’s assets up into Part 1 Assets, including “the SafeMoon Wallet, DEX, intellectual property of the Debtor,” and Part 2 Assets, which included “social media accounts and related assets . . . the SFM v2 Tokens, SafeMoon v2 Smart Contract, SFM v1 Tokens and SFM V1 Smart Contract.”⁷ Often, as shown in SafeMoon, these one-off sales are accompanied by the SEC’s reservation of rights to protect its ability to object to plans potentially harmful to investors or market integrity.⁸ The SEC typically files a reservation of rights in a bankruptcy liquidation to protect its ability to object to plans and to not create the impression to the market that the SEC had “approved” the deal by not objecting.

9019 Settlement Example. Settlement-related sales in bankruptcy involve extensive negotiations to balance stakeholder interests. Prime Trust (“Prime”) was the first crypto trust company to ever file bankruptcy. During the Prime Chapter 11 proceedings, the estate sought approval to sell assets initially provided by a customer called Tiki Labs, Inc. d/b/a Audius (“Audius”). Instead of litigating that issue to conclusion, the estate resolved the dispute with Audius by selling AUDIO most of the crypto at issue, AUDIO. With respect to the remaining AUDIO held by the estate, the estate and Audius agreed to a liquidation

plan in which the estate would “not liquidate in excess of 10% of” the prior day’s 24-hour trading volume as reported on CoinGecko.com. In connection with that settlement, Audius agreed to withdraw its objection to the proposed plan of reorganization and relinquished all claims against the estate.

One unique aspect of this settlement agreement was that there were actually multiple customer accounts at Prime related to the AUDIO held by Prime. Audius effectively negotiated on behalf of all of them. But the estate required a joinder in which each account holder had to agree to the terms in order for Prime to release the AUDIO to them.

II. STRATEGIC CONSIDERATIONS

The key strategic component is avoiding litigation about any potential deal. Objections and litigation from the SEC, other regulators, or creditors groups costs resources and can delay deals for months. If during the pendency of the litigation the crypto prices shift, it could kill the deal entirely. That is why it is important to interface with the key potential objectors up front with a detailed plan and regulatory strategy. For each deal, mapping out exactly how the deal complies with U.S. securities and money transmitter regulations in particular is key. For each deal. One should consider the crypto assets at issue and decide whether the deal can be executed with less regulatory friction if certain assets are left out of the deal, restrictions are placed on the buyer to not re-sell those assets into the United States, or other timing restrictions on re-sales are placed on buyers. Proactively coming up with a regulatory plan up front will often lead to a more receptive regulators, U.S. trustees, and creditor groups.

Many components of crypto asset restructuring require the ability to adapt and anticipate moving targets due to evolving regulations, volatile asset values, and unique transaction complexities.

⁶ See Voyager on Twitter: “1/ Today we received a letter from <https://t.co/yG7Airmib5> terminating the asset purchase agreement. While this development is disappointing, our chapter 11 plan allows for direct distribution of cash and crypto to customers (a “toggle option”) via the Voyager platform.” / Twitter (archive.org).

⁷ See Safemoon US LLC, Case No. 23-25749-MEW, Docket No. 201, (Bankr. D. Utah July 16, 2024).

⁸ Safemoon Docket No. 207 (Bankr. D. Utah August 1, 2024) (The SEC stated that it “does not object to the relief sought by the motion. However, the SEC takes no position as to the legality of the transaction, under the federal securities laws, proposed in the Motion” and otherwise reserved all rights to challenge transactions involving crypto assets on a go-forward basis.).

The keys to understanding the complexity of these deals lie in the unknown timing considerations and the rapid fluctuation in the value of the underlying assets. Additionally, the agreements that facilitate these deals are subject to bankruptcy court approval, adding another layer of timing complexity. An extra day or two can drastically impact the price, making precise timing crucial. **This volatility and timing uncertainty necessitates careful planning to mitigate potential financial losses. Contractual conditions can be established to address these issues, including clauses that account for timing and value fluctuations.** For example, an asset purchase agreement for crypto in a bankruptcy context could contain a provision that allows the buyer to cancel the purchase if the value of the crypto drops below a certain level (e.g., 80% of the value on the day the purchase agreement is signed). It is also important for all parties to tether the prices of the crypto asset at issue to a specific point in time and using an agreed upon price discovery website, usually the “close” at www.coinmarketcap.com or www.coingecko.com.

III. CONCLUSION

During the crypto winter the collapse of major players highlighted the complexity and rapid evolution of the crypto industry, leading to novel bankruptcy and distressed asset scenarios. Professionals grappled with new issues and deal structures, while bankruptcy courts took on quasi-regulatory roles, addressing unique legal challenges. Regulators faced the difficult task of making policy decisions without clear guidance or precedent. Crypto bankruptcies are complicated by the volatility and complexity of crypto assets and the rapid evolution of the underlying technologies. **Although bankruptcy courts have adapted remarkably well, the U.S. Bankruptcy Code was not designed for crypto assets. Lessons from early crypto bankruptcies will certainly shape future bankruptcy and distressed asset liquidations.** Close

collaboration with regulators, courts, and legal and consulting professionals is crucial for successful crypto bankruptcy transactions.

PANEL

CLIFFORD CHANCE LIVE STREAM PANEL SESSION: EXPLORING THE TOKENIZATION OF ASSETS AND FUNDS



We were thrilled to host a distinguished line up of speakers for a panel on tokenization of assets and funds as part of our recent **Future of Digital Finance event** jointly hosted with GBBC.

Speakers:

- Stefano Dallavalle, Head of Product, Digital Assets, R3
- Marjan Delatinne, SVP Business Development, Digital Asset
- Jesse Overall, Associate, Clifford Chance (Moderator)
- Nikhil Sharma, Executive Director, Head of Growth, JP Morgan
- Breige Tinnelly, Head of Market Development, Archax

Our key takeaways:

- **Progress and benefits:** Tokenization has moved from proof of concept

to real-world applications, offering improved efficiencies, cost savings and getting ever closer to atomic settlement.

- **Interoperability and collaboration** among industry and global regulators will be essential for achieving the full potential of tokenization, ensuring various ledgers and tokenized assets can interact seamlessly and enabling the mobility of collateral and assets across different platforms.
- **Regulatory clarity and global standards** are crucial for fostering innovation and market confidence, with regions with clear regulations attracting more interest.
- **Future of tokenization:** predictions around the impact of tokenization on various sectors and products including real estate, money market funds, and collateral management.

[VIEW THE PANEL](#)

International Handbook of AI Law

A Guide to Understanding and Resolving the Legal Challenges of Artificial Intelligence

Overview

International Handbook of AI Law, an indispensable handbook, written in clear language by international experts from all over the world, elucidates the complex relationship between AI and the law, covering both existing laws and emerging AI-specific legal regulations. Recently, the field of Artificial Intelligence (AI) has seen remarkable advances, revolutionizing how we live, work, and interact with technology. As AI systems grow increasingly sophisticated and autonomous, they raise new and challenging legal questions, particularly regarding AI-specific risks associated with automated systems.

What's in this Book

is of how AI works and progresses with chapters covering a wide array of legal fields relevant to AI technology focusing on the legal framework in the EU.

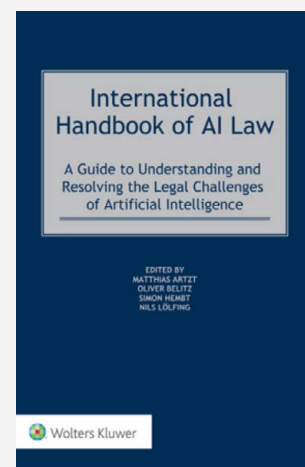
The topics included are:

the EU AI Act;
AI-Specific Liability and Product Safety;
Data Protection;
Data Law;
Intellectual Property;
Contracting;
Antitrust;
Criminal Law;
Cybersecurity;
Employment Law; and
Legal Tech.

The book concludes with country reports on the legal and regulatory environment in the United Kingdom, the United States, China, and Japan, contrasting them with the EU legal framework.

How this will help you

Every chapter provides pragmatic advice on the implementation of legal principles, making the handbook a valuable resource for real-world applications. This essential guide will prove to be immensely valuable to practitioners, policymakers, academics, and others seeking a deep understanding of the complex legal challenges posed by AI use. The handbook aids in responsible and trustworthy AI development and use by guiding decision-making, reducing risks, and protecting the rights and well-being of individuals and society.

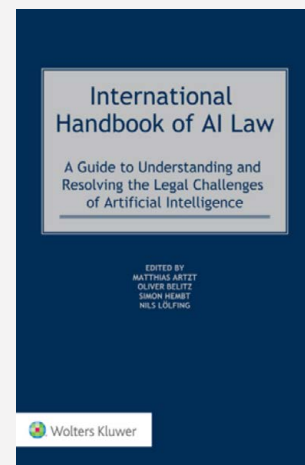


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Table of Contents

Editors	CHAPTER 7
Contributors	Contracting for AI in B2B
List of Abbreviations	
Preface	
	CHAPTER 8
CHAPTER 1	Antitrust
Understanding AI	
	CHAPTER 9
CHAPTER 2	AI and Criminal Law
The EU Artificial Intelligence Act	
	CHAPTER 10
CHAPTER 3	Cybersecurity
AI-Specific Liability and Product Safety Requirements	
	CHAPTER 11
CHAPTER 4	AI and Employment Law: AI in the Employment Lifecycle
Data Protection Law	
	CHAPTER 12
CHAPTER 5	AI and Legal Advice (Legal Tech)
Data Law	
	CHAPTER 13
CHAPTER 6	Comparative Law Perspective
Artificial Intelligence and Intellectual Property	
	Bibliography
	Index



**International Handbook
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HOW CAN I GET INVOLVED?

Interested in submitting new work or becoming an editor for the International Journal of Blockchain Law (IJBL)? Review the below submission guidelines and then email us at law@gbbcouncil.org.

Length	3-4 print pages including footnotes
Target Audience for Submission	Broader business community aiming to better understand the technology and the legal issues associated with it
Content	All legal areas related to blockchain technology and digital assets
Structure	Introduction - Description of legal matter - Proposed solution - Conclusion/key takeaways
Writing Style	Not too academic; lucid and clear-cut language
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