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Crypto assets in legal practice

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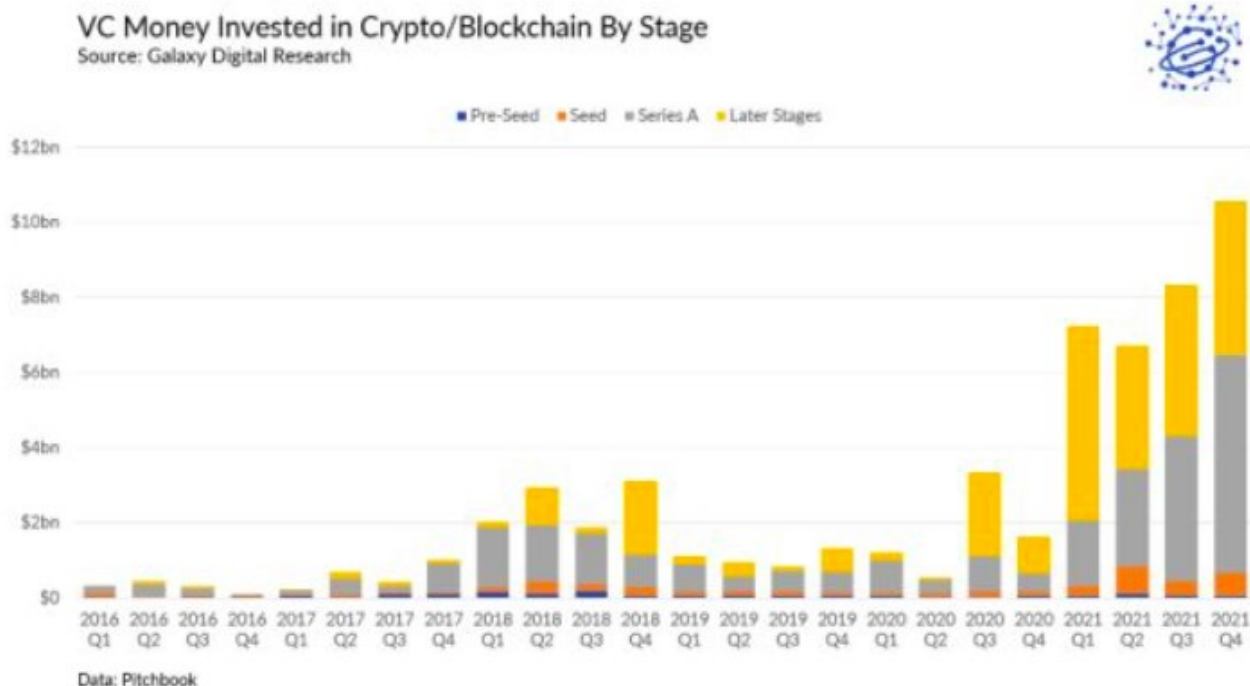
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HIGHLIGHTS

- 1) CRYPTO ASSETS – THE PHENOMENON OF OUR TIME?
- 2) BLOCKCHAIN
- 3) CRYPTOCURRENCIES AND TOKENS
- 4) SMART CONTRACT
- 5) LEGAL NATURE OF CRYPTOCURRENCIES IN THE CZECH REPUBLIC
- 6) MAIN LEGAL REGULATION IN THE CZECH REPUBLIC
- 7) NON REGULATION / REGULATION OF PARTICULAR ACTIVITIES
- 8) NEW REGULATION IS COMING – MICA
- 9) FATF RECOMMENDATIONS



CRYPTO ASSETS – THE PHENOMENON OF OUR TIME?



Sources: <https://ncfacanada.org/galaxy-digital-research-crypto-vcs-biggest-year-ever-2021/>

- In 2021 Venture capitalists invested more than \$ 33bn into crypto/blockchain startups and Crypto/blockchain startups received almost 5% of venture capital
- \$ 22bn of that total (67%) went to fundraising rounds with deal sizes above \$ 100m
- In CZ the volume of purchased crypto assets was 3bn Czech crowns in 2021



BLOCKCHAIN

- Crypto assets are based on blockchain technology
- Blockchain is one of the types of the Distributed Ledger Technology (special distributed database)
- Distributed Ledger Technology is a decentralized database that stores data on a distributed basis, without a single administrator
- Copy of the database is stored in many devices. These devices create network
- The data are entered and updated by the individual entities involved in the database
- Any changes can only be written and saved to all involved devices after approval by the majority of devices
- Blockchain is specific to the effect that the records made do not change, but are appended to them and arranged in so-called blocks, thus representing a linearly growing database
- Cryptography ensures the integrity
- **Blockchain and responsibility – this matter is not resolved**



CRYPTOCURRENCIES AND TOKENS

- Coins vs. tokens - a Blockchain can only have one native asset (coin), whereas it can have hundreds of tokens built on top of it
- Fungible vs non-fungible tokens
 - Fungible tokens or assets are divisible and non-unique (e.g. Bitcoin)
 - Nonfungible assets, on the other hand, are unique and non-divisible. They should be considered as a type of deed or title of ownership of a unique, non-replicable item (e.g. flight ticket, house, car)
- Tokens
 - Currency tokens – payment purpose
 - Utility tokens – access to product or service
 - Asset tokens – investment or security tokens. Participation of investor on some company or entity or project or an investor's claim on the issuer



SMART CONTRACT

- Smart contracts are simply programs stored on a blockchain
- Smart contracts run when predetermined conditions are met - typically are used to automate the execution of an agreement
- Narrower concept - a computer program - an algorithm that can independently realize, verify or limit performance
- Broader concept - a piece of code stored on a blockchain that executes blockchain transactions, reads and writes data in a blockchain database
- Smart contract is executed:
 - Automatically
 - Without human intervention
 - Using a computer program
- Disadvantage of smart contract - the contract may not match reality (e.g. a lease agreement for an item that has expired or not longer exists)



LEGAL NATURE OF CRYPTOCURRENCIES IN THE CZECH REPUBLIC

- Article 489 of the Act No. 89/2012 Coll., Civil Code - A thing in a legal sense is everything that is different from a person and serves the needs of people
- The cryptocurrency as a thing in the legal sense:
 - Incorporeal - Cryptocurrency has no cash alternative. Ownership is recorded in an electronically maintained database
 - Movable – Immovable things are defined in Article 498 par. 1 of the Civil Code (Immovable things are tracts of land and underground structures with a separate intended purpose). All other things, whether of a corporeal or incorporeal nature, are movable
 - Fungible vs Non fungible things - may be disputed
- The judgements of the Regional Court in Brno - judgment of 17 February 2022, no. 30 Af 29/2020, of 24 March 2022, no. 30 Af 41/2022 - *Administrative Authorities stated that bitcoin should be considered as a different thing, since according to Article 489 of Act No. 89/2012 Coll, Civil Code, everything that is distinct from a person and serves a need of people is a thing. In view of its virtual nature, they classified Bitcoin as an intangible movable thing*
- The opinion of the Czech National Bank dated 19/11/2018, file no. RS2018-13 *Transfer tokens do not even exhibit the characteristics of an investment instrument under Section 3 of the Capital Market Undertaking Act (note: the Capital Market Undertaking Act), as no right is embodied in them*



MAIN LEGAL REGULATION IN THE CZECH REPUBLIC

- AML regulation – Act. No. 253/2008 Coll., on selected measures against legitimisation of proceeds of crime and financing of terrorism
 - Section 2 par. 1 letter I) - For the purposes of this Act, an obliged entity means a person providing services related to virtual assets
 - Section 4 par. 8 - For the purposes of this Act, a person providing services related to virtual assets means a person engaged in a business activity in a form of purchase, sale, safekeeping, administration for another person, transfer or brokering of purchase or sale of virtual assets, or a person providing financial services related to issue and sale of virtual assets or other similar services related to virtual assets
 - Section 6 - Suspicious Transaction, Section 8 – Identification Process, Section 9 - Customer Due Diligence, Section 16 - Record Keeping by Obligated Entity - For 10 years following the execution of a transaction or termination of a business relationship, Section 21 + 21a - Internal Procedures + Risk Assessment
- Financial Analytical Office controls the trade licence
- There is no register of cryptocurrency service providers
- Decentralized Crypto Exchange – there is no regulation under AML regulation



NON REGULATION / REGULATION OF PARTICULAR ACTIVITIES

NON REGULATED ACTIVITIES

- Trading cryptocurrencies – not a payment service
- Receiving payments for goods and services in cryptocurrency – not direct regulation
- Exchange of cryptocurrency for money (FIAT currency) - not an exchange activity
- Cryptocurrency exchange (supply and demand of cryptocurrencies) - not a market organisation for investment instruments or a commodity exchange
- Arranging/Brokerage trading on a cryptocurrency exchange – not an investment service BUT service receiving orders, transmitting and executing them may be a payment service - payment services licence could be required

REGULATED ACTIVITIES

- Trading derivatives on cryptocurrencies - investment services license is required
- Managing a fund investing in cryptocurrencies - a license to manage a fund is required
- Initial Coin Offering (Public offer for the issuance of cryptocurrency) - may be a public offering of investment securities



NEW REGULATION IS COMING - MICA

- REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937
- Adoption of new regulation is in the process – the regulation is now in process of approving in The Committee on Economic and Monetary Affairs. It is expected to be forwarded to the European Parliament for plenary approval
- The aim is to create a consistent regulatory framework for crypto assets among EU member states
- The aim is to ensure the transparency regarding issuing the crypto assets and regulation of the cryptocurrency market
- Defines selected types of crypto assets, e.g. utility token (*means a type of crypto-asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token*), electronic money token (r) *means a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender*
- Regulation of services connected with crypto assets



NEW REGULATION IS COMING - MICA

- Crypto-asset white paper – Article 5 of MiCA defines the information that have to be provided to “clients”
- A **detailed description of the issuer** and a presentation of **the main participants involved** in the project's design and development
- A detailed description of **the issuer's project**, the **type of crypto-asset** that will be offered to the public
- A detailed description of **the characteristics of the offer to the public**, in particular **the number of crypto-assets** that will be issued
- A detailed description of **the rights and obligations attached to the crypto-assets** and **the procedures and conditions for exercising those rights**
- Information on the **underlying technology and standards applied by the issuer of the crypto-assets** allowing for the holding, storing and transfer of those crypto-assets
- A detailed description of the **risks relating to the issuer of the crypto-assets**, the crypto-assets, the offer to the public of the crypto-asset and the implementation of the project



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NEW REGULATION IS COMING - MICA

- Warning statements:
 - The crypto-assets may lose their value in part or in full
 - The crypto-assets may not always be transferable
 - The crypto-assets may not be liquid
 - Where the offer to the public concerns utility tokens, that such utility tokens may not be exchangeable against the good or service promised in the crypto-asset white paper, especially in case of failure or discontinuation of the project



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FATF RECOMMENDATIONS

- TFR – Transfer of Funds Regulation
- Based on FATF (The Financial Action Task Force) recommendations in 2021
- Extending the information about the participants of cryptocurrency transfer
 - Duty to control and store the information about the origin of crypto asset
 - Screening against the list of risk subjects of EBA (European Banking Authority)
 - The application of obligations regardless of the amount of the transaction
- Travel Rules for crypto-assets (cryptocurrency exchange)



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Thank you for your attention