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Blockchain Bites: Citi: Tokenisation is blockchain's "killer use case", CFTC calls crypto 'commodities' in Binance case, Debates over DAO governance, New EU AML rules for unhosted wallets

Michael Bacina, Steven Pettigrove, Jake Huang, Luke Misthos, Luke Higgins and Kelly Kim of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Tokenisation is blockchain's "killer use case": Citi

One of the world leading financial institutions, Citi, has released a report arguing that blockchain technology is at an "inflection point" and that the tokenisation of financial and real-world assets could be blockchain's "killer use-case".

Citi's report on "Money, Tokens, and Games" predicts that tokenisation in private markets will grow significantly, with an estimated value of up to USD$4 trillion by 2030, representing a growth factor of over 80x. Citi also estimates that up to USD$5 billion in CBDCs and stablecoins could be circulating in major economies by 2030 and that USD$1 trillion of the repossession, securities financing, and collateral market will be tokenised this decade.

Tokenisation refers to the process of converting financial or real-world assets, such as securities, artwork, or real estate, into digital tokens that can be stored and exchanged on a blockchain-based platform. It has long been put forward as one of the key use-cases of blockchain technology. According to Citi, the benefits of tokenisation, particularly for private funds and securities, are expected to drive demand-side adoption, replacing expensive reconciliations and settlement failures with increased operational efficiency, fractionalisation, and expanded accessibility to a wider range of market participants.

In its report, Citi delves deeply into the tokenisation of specific types of financial assets (such as digital securities), exploring the essential components required beyond the blockchain technology itself for the scaling of securities tokenisation. This includes a fully digitised workflow, support from traditional finance layers (like banks), technology neutral-laws, standardised taxonomy, and built for purpose legislation and regulation.

The tokenisation of financial and real world assets raises a number of legal considerations including:

1. Securities law compliance: depending on the nature of the asset and the jurisdiction in which it is being tokenised, the tokens may be considered securities under applicable laws. As such, the issuance and trading of the tokens must comply with relevant securities laws and regulations, including registration requirements, disclosure obligations, and anti-fraud provisions for example.
2. Property law: tokenisation of real-world assets raises questions about property ownership and transfer. The legal rights and obligations associated with owning and transferring the underlying asset must be carefully considered and addressed in the tokenisation process.
3. Taxation: the tokenisation of financial and real-world assets may have implications for investors and issuers, including capital gains tax, sales tax, and indirect tax.

The tokenisation of financial assets is quietly gathering steam, with major US institutions such as State Street and KKR exploring tokenised funds and private assets. Blackrock, one of the world's leading asset managers, is also preparing for a tokenised future. In his 2023 Chairman's letter, Blackrock's Chairman, Larry Fink, expressed optimism over the "exciting applications" of blockchain technology, noting "the tokenization of asset classes offers the prospect of driving efficiencies in capital markets, shortening values chains, and improving cost and access for investors". Fink has previously described

tokenisation of stocks and bonds as the "next generation of markets".

Citi's latest report captures the potential promise of tokenisation of financial and real-world assets. The widespread tokenisation of assets would have significant implications for financial markets. While significant institutional and legal issues remain to be traversed, many of the world's leading financial institutions are preparing for a tokenised future.

CFTC calls crypto 'commodities' in case challenging CZ / Binance

In early April, the US Commodities and Futures Trading Commission (CFTC) filed a lawsuit against Binance, the largest crypto trading platform by volume. The CTFC allegation contains a number of very serious allegations which may cause very significant issues for Binance, but the case also raises an interesting point regarding several cryptocurrencies, including Ether, Litecoin and stablecoins listed on Binance, which the CFTC allege in their pleadings are properly classified as commodities.

For any case brought by a regulator, first jurisdiction must be shown for the regulator to enforce rules. In this matter the CFTC has alleged that the cryptocurrencies in question are properly seen as commodities under US law. In a House Appropriations Committee budget hearing on 28 March 2023 CTFC Chairman Rostin Behnam stated his opinion on Ether:

> *I believe they are a commodity…And because they are listed on CFTC exchanges, we do have a regulatory relationship – obviously with the derivatives market and that product, but the underlying market as well.*

The CFTC's position on cryptocurrency puts it in opposition to the US Securities and Exchange Commission (**SEC**). The SEC chair, Mr Gary Gensler has zealously pursued the SEC's jurisdiction over all crypto assets through an aggressive regulation by enforcement stance while being roundly criticised by industry and at least one court for failing to provide guidance as to how crypto businesses could comply with the existing rules.

While the SEC has been criticised for failing to provide an adequate registration processes for crypto projects, the majority of which are actively pursuing regulatory compliance, the CFTC throwing their regulatory hat in the ring could lead to tensions and inconsistent rules between the two bodies, but may provide at least some measure of certainty for certain crypto-assets. Interestingly Australia has no distinct definition of 'commodity' under the *Corporations Act* but the recently introduced private members bill *Digital Assets (Market Regulation) Bill* does contain a definition of commodity (but definitionally carves out any financial products / securities from falling under the definition of tokens in that Bill).

The CFTC also appears far more united than the SEC, with SEC Chair Mr Gensler regularly refuted by SEC Commissioner Hester Peirce who advocates firmly the need to provide clear and transparent rule-making around this growing industry.

Debates over DAO governance heat up

This week ArbitrumDAO, the newly-established DAO governing the Ethereum Layer-2 scaling project Arbitrum, was forced to backtrack on a key governance proposal to transfer $1 billion worth of its governance token (ARB) to capitalise the Arbitrum Foundation.

The proposal was initially set to go ahead without the approval of ARB token holders who make up the ArbitrumDAO that in theory governs Arbitrum. The Arbitrum Foundation branded the proposal as a "ratification" and wanted to press ahead before the conclusion of a governance vote by token holders, who were overwhelmingly against this proposal.

In the face of criticism over a perceived lack of autonomy at the DAO, the Arbitrum Foundation sought to defend the ratification proposal in a governance forum post:

> *"When it comes to setting up a DAO, there's a chicken and an egg problem…certain parameters involving code transfer, security council creation and the drafting of a constitution needed to be set before the DAO could take over."*

This response did not seem to satisfy token holders and the wider crypto community who took to Twitter to voice their concerns over the lack of consultation:

Eventually, the Arbitrum Foundation bowed down to pressure and agreed to amend the proposal allowing tokenholders to vote on it separately:

> *it's now time to incorporate community feedback, and move forward with new AIPs (note: Arbitrum Improvement Proposals) and documentation that address key areas of concerns.*

Some will see this as a win for DAO governance – that decentralised governance works even when it goes against the wishes of a founding team or influential group. However, the Arbitrum backlash also raises the important question of whether an organisation can really function from the bottom up, at least in the beginning stage and especially when huge amounts of money are involved.

The Arbitrum controversy contrasts with the recent successful overhaul of MakerDAO's governance structure. MakerDAO is the DAO behind Maker, a $7 billion lending platform that also issues the $5.3 billion stablecoin DAI, backed mainly by the value of digital assets from borrowers. Just a few weeks ago, MakerDAO's community approved several sweeping reforms, including a new "Constitution" drafted by MakerDao's founder Rune Christensen.

The proposals include breaking up the DAO's current structure into smaller units called SubDAOs, which are self-governing and self-sustaining entities with their own tokens within the MakerDAO ecosystem. The plan also aims to boost platform revenues by investing a part of Maker's more than $7 billion in reserves into real-world assets and money-market funds, further diversifying the backing of the DAI stablecoin to make it more resistant against censorship and sanctions.

Andreesen Horowitz (a16z), a leading venture capital firm and significant tokenholder in MakerDAO had raised concerns over aspects of the proposal. The constitution was nevertheless approved by 76% of MakerDAO's community.

The MakerDAO Foundation said concerns over "misalignment" were one of the driving forces behind the changes:

> *The reason that alignment with a greater purpose beyond just financial return is so important is that indifferent, misaligned participants who are motivated to take part in Maker Governance purely for the sake of financial returns, while aligned in some areas of economic gain, will have nothing stopping them from exploiting opportunities to extract value for themselves even if it comes at a cost to the broader community.*

The Foundation presents the new Constitution as an effective way of "alignment engineering":

> *The Maker Constitution specifies a maximally unchangeable scope of Maker Governance to the extent it is reasonable. This helps ensure transparency and reduce complexity asymmetry because the core processes and frameworks change minimally, enabling token holders to follow along.*

It also says that SubDAOs will create efficiency for ongoing governance:

> *"SubDAOs are semi-independent DAOs that are linked to Maker Governance and whose core design enables a derisked, second layer of the ecosystem to foster fast-moving, unconstrained innovation, growth and experimentation. SubDAOs also enable delegation of responsibility and risk within specific, highly complex areas. In general, complexity, responsibility, decision-making authority and risk is off-loaded from Maker Core and pushed to the SubDAOs, except if the Maker Constitution specifies otherwise."*

The controversy over ArbitrumDAO and the MakerDAO constitution are just two recent examples of debates sparked by the

desire to balance efficiency and decentralised governance within DAOs. The debates themselves are an indicator of a passionate and engaged community and provide interesting case studies on the tensions involved in decentralised governance as DAO governance continues to evolve.

EU backs new AML rules for unhosted wallets

The EU continues to progress new anti-money laundering and counter-terrorist financing (**AML/CTF**) laws for crypto assets, with parliamentary committees approving positions on three pieces of AML/CTF related legislation last week.

The draft legislation would impose strict requirements on cryptoasset service providers (**CASPs**) to identify the users of unhosted wallets. Under the proposals, where a customer transacts with an unhosted wallet, the CASP would need to identify the counterparty behind the unhosted wallet for all transfers over €1,000.

The committee approvals follow a provisional deal struck by the EU Parliament and EU Council last July. Under the draft legislation, CASPs would be forbidden from processing transactions greater than €1,000 if they cannot identify a counterparty, or unless another regulated CASP is counterparty to the transfer.

The legislative package also contemplates the establishment of a central EU AML Authority (**AMLA**). The AMLA will be assigned supervisory and investigative powers to enforce compliance with AML/CTF measures. This new authority is expected to ensure consistent enforcement of the new regulations.

In addition, the draft legislation requires the establishment of a Financial Intelligence Unit (**FIU)** in each member state to prevent, report and address AML/CTF risks. FIUs would share information with each other and with competent authorities as well as cooperate with AMLA, Europol, Eurojust and the European Public Prosecutor's office.

The EU Parliament is planning to commence final negotiations on the legislation in April.