

Article Information

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Blockchain Bites: 52,560 Blocks in Review, IOSCO publishes its final report on DeFi, UK's Digital Securities Sandbox welcomed by industry, UAE's AML Upgrade: Escaping the Grey List?

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

52,560 Blocks in Review

Each year approximately 52,560 blocks are mined on the Bitcoin Blockchain, and while we sadly can't produce a Bits of Blocks post every 10 minutes, we do our best to bring you informative and concise blocks of information.

This year there have been a number of stories which have grabbed our attention, honourable mentions include when [Stoner Cats were found to be a security by the SEC](#), and when [Rihanna joined the NFT game](#) by tokenising her music.

So as this year winds down we take a look back on ten popular articles we brought to you:

1. February saw the [United Kingdom \(UK\) kick off its digital asset consultation](#) by proposing a regulatory regime for crypto assets and emphasising the importance of international cooperation.
2. [Dubai joined the party](#) soon after with its tiered licensing process for Virtual Asset Service Providers.
3. The co-founder and CEO of Terraform Labs, the backer of the Luna USD stablecoin [Do Kwon was arrested in Montenegro](#) with a fake Costa Rican passport.
4. The world's first comprehensive digital asset legislation, the [Markets in Crypto-Asset Regulation or MiCA was translated and approved by the European Union](#) with the key provisions coming into effect in 2024.
5. The [Australian Taxation Office \(ATO\) released public guidance](#) on the application of GST for certain digital currency interactions and provided clarity on certain crypto assets that are *not* digital currency for the purposes of its guidance.
6. [Grayscale Investments successfully appealed](#) in the Court of Appeals for the District of Columbia Circuit against the SEC's denial of their proposed Bitcoin Exchange-Traded Product signifying a major victory for the crypto industry.
7. The long awaited [Australian Treasury Digital Asset Platforms Consultation](#) was released establishing a roadmap for regulating digital asset platforms, proposing a new class of financial product called a "digital asset facility", and requiring certain platforms to obtain an AFSL.
8. Former [FTX CEO Sam Bankman-Fried was found guilty](#) on all charges by a jury following a four hour deliberation in a Manhattan federal court. The verdict sent shockwaves through the industry with sentencing set to occur in March 2024.
9. [Cryptocurrency was taken off ASIC's list of top enforcement priorities](#) for 2024 following a blazing 2023 which saw Binance, Qoin, Block Earner and more receive regulatory heat from ASIC.
10. Microsoft and Sony, two of the biggest players in the gaming and tech spheres are [making significant strides in integrating digital assets](#) into their gaming systems. Microsoft's Xbox is looking to allow users to link their digital wallet to their Xbox and Sony is looking to tokenise in-game assets to sell on secondary markets.

Thank you

While we continue to plug away over the break, we will also take some time to reflect on the many highs and lows of 2023. 2024 promises to be another big year with animal spirits running wild again in the crypto markets, the first spot Bitcoin exchange traded fund seemingly on the cards for the US signalling tighter integration between crypto assets and mainstream markets, and Australia's Treasury moving forward with draft legislation on regulating digital asset platforms.

From everyone at Bits of Blocks, thank you and we will see you in the new year!

By M Bacina, S Pettigrove, T Masters and the Piper Alderman Blockchain team

IOSCO publishes its final report on DeFi

The International Organization of Securities Commissions (IOSCO) has [issued its final report](#) with policy recommendations for Decentralised Finance (DeFi).

DeFi, characterised by its use of distributed ledger or blockchain technologies, aims to revolutionise finance by operating in a disintermediated and decentralised manner.

The IOSCO paper acknowledges the potential of DeFi to foster financial innovation, enhance efficiencies, and improve access to financial products. It also underscores the importance of responsible innovation that benefits investors and markets, aligning with the rapid evolution of DeFi technologies.

In this context, IOSCO has formulated the following nine primary policy recommendations which are briefly summarised below:

1. **Analyse DeFi Products, Services, Activities, and Arrangements to Assess Regulatory Responses.** IOSCO recommends that regulators should scrutinise DeFi projects on a jurisdiction-by-jurisdiction basis, considering equivalence of the project to traditional finance, while acquiring the necessary technological expertise for comprehensive analysis of the project.
2. **Identify Responsible Persons.** Regulators must identify the "Responsible Person/s" in DeFi projects, encompassing those with control or influence over the assets or project.
3. **Achieve Common Standards of Regulatory Outcomes.** Regulators should employ their existing frameworks or new frameworks aligned with the IOSCO Standards to regulate and supervise DeFi consistently across jurisdictions.
4. **Require Identification and Addressing of Conflicts of Interest.** Regulators should mandate Responsible Persons to identify and address conflicts of interest, assessing if measures like legal disaggregation are necessary for risk mitigation.
5. **Require Identification and Addressing of Material Risks, Including Operational and Technological Risks.** Responsible Persons should be required to identify and address material risks of the DeFi project, including operational and technological risks.
6. **Require Clear, Accurate, and Comprehensive Disclosures.** Responsible Persons should also be required to accurately disclose comprehensive and clear (i.e. not technical) information pertinent to the DeFi products and services.
7. **Enforce Applicable Laws.** Regulators should wield comprehensive powers for authorisation, inspection, investigation, surveillance, and enforcement over DeFi and Responsible Persons.
8. **Promote Cross-Border Cooperation and Information Sharing.** IOSCO acknowledges the cross-border nature of DeFi and blockchain, stating that regulators should possess the capability to cooperate and share information with counterparts in other jurisdictions.
9. **Understand and Assess Interconnections Among the DeFi Market, the Broader Crypto-Asset Market, and Traditional Financial Markets.** Regulators must grasp the interconnections within DeFi arrangements and the broader blockchain industry.

While the release of forward-looking guidance for blockchain is well-received, a number of the recommendations put forth by IOSCO emphasise traditional risk frameworks, which are constructed around centralised intermediaries, raising concerns about their adaptability to decentralised technologies and permissionless system. The call for identification of "responsible persons" in particular may be regarded as tantamount to re-centralisation in the provision of financial services.

The report's principles-based and outcomes-focused approach aligns with IOSCO's globally accepted standards for securities markets regulation. However, the application of these principles to DeFi without significant modification may hinder rather than foster the growth of this transformative sector. Many industry participants took to X to express their



concerns:

IOSCO's emphasis on consistency in the regulation and oversight of crypto-asset markets is understandable, given their cross-border nature and the potential for regulatory arbitrage. However, the call for "same activity, same risk, same regulatory outcome" may inadvertently overlook the distinctive features of DeFi, which inherently diverge from traditional financial activities. In that context, a "similar risk, similar activity, and same regulatory outcome" approach as [adopted by Australia's Treasury in its recent consultation on regulating digital asset platforms](#) may be more appropriate.

While IOSCO's efforts to establish regulatory frameworks for DeFi are commendable and a number of the recommendations are sensible ones, a more nuanced approach is essential. DeFi's potential represents a paradigm shift in finance, and applying traditional risk frameworks without tailoring them may be detrimental. Regulators must strike a delicate balance between ensuring market integrity and investor protection and allowing room for the continued innovation and growth of the decentralized financial ecosystem which remains at a nascent stage of development. As the regulatory landscape evolves, collaboration between regulators and the industry is crucial to create a regulatory framework that nurtures innovation while safeguarding ordinary market participants and consumers.

By M Bacina, S Pettigrove, T Masters and L Higgins

UK's Digital Securities Sandbox welcomed by industry

The UK Treasury's consultation on the Digital Securities Sandbox (DSS) has concluded [attracting positive industry feedback](#). The DSS is expected to be run by the Bank of England and Financial Conduct Authority to facilitate digital asset adoption in the UK. Submissions were received from a range of industry participants including incumbent FMI firms, financial services firms interested in digital assets, new entrants, technology firms and non-governmental organisations.

In HM Treasury's final [report published this week](#), it was noted:

Feedback praised the emphasis on facilitating innovation, without compromising on regulatory outcomes

In the report, the government affirmed its intention to keep the DSS technology neutral and flexible to accommodate different structures. Respondents welcomed this flexibility to test digital securities and distributed ledger technology under a modified legislative framework and regulatory supervision. This is mutually beneficial as it allows UK regulators to

set sensible limits on a case-by-case basis and make informed amendments to the rules.

The majority of respondents agreed that 5 years would be an appropriate timeframe for the DSS, given that a permanent legislative framework can be established during this time. There was general support for a cross-industry regulatory body and global coordination for digital assets regulation, emphasising the need for a collaborative approach.

While acknowledging the initiative as a step in the right direction, the industry stressed further clarity surrounding:

the application process, the management of limits set in the DSS, the interaction of activities in the DSS with activities outside...[and] the process for exiting.

In respect of the ambiguities, the government has promised that details will be published by regulators in due course.

The regulations establishing the DSS, [The Financial Services and Markets Act 2023 \(Digital Securities Sandbox\) Regulations 2023](#), were laid before Parliament on 18 December 2023 and will take effect on 8 January 2024.

The UK government will continue cooperating with regulators and industry to:

identify any further legislative provisions that need to be brought into scope, and if necessary, can facilitate this via further statutory instruments amending the DSS.

The UK Government's swift action to establish a regulatory framework for the DSS is striking as the UK and London continue to evolve as a global financial centre. A number of other jurisdictions are also taking swift action to embrace the promise of blockchain technologies by establishing fit for purpose regulations and regulatory sandboxes. In this context, the time is ripe for Australian policymakers to explore a broader digital asset sandbox for Australian innovators and consumers pending the introduction a comprehensive regulatory framework for digital assets.

By M Bacina, S Pettigrove and K Kim

UAE's AML Upgrade: Escaping the Grey List?

On 21 December 2023, the United Arab Emirates' Financial Services Regulatory Authority (**UAE FSRA**) published the [revised Anti-Money Laundering and Sanctions Rules and Guidance](#). The revised Rules introduce new provisions relating to wire transfers to provide greater clarity that the Financial Action Task Force (**FATF**) "Travel Rule" applies to Virtual Assets.

The [FATF is a Paris-based inter-governmental which consists of 36 member countries](#) established to combat money laundering and terrorism financing. The "Travel Rule" (technically "[FATF Recommendation 16](#)") is a set of guidelines which applies to financial institutions engaged in virtual asset transfers (called "VASPs") and mandates a requirement for VASPs to obtain and disclose precise details pertaining to the sender and recipient of Virtual Asset transfers.

In a [statement on 21 December 2023](#), the FSR have said:

The **FSRA** has made revisions that clarify the requirements that previously appeared in the AML Rulebook, reflecting the federal regulatory framework the UAE has put in place to combat money-laundering, the financing of terrorism and proliferation financing and ensure compliance with targeted financial sanctions

The updated rules provide that payments using virtual assets are covered within the scope of the regulation and reflect UAE's progressive approach towards the evolving nature of financial transactions. The Rules seek to ensure virtual asset transactions in the UAE are aligned with the global standards set by FATF and mark a significant advancement in UAE's cryptocurrency regulation.

In early 2022, the Financial Action Task Force (**FATF**) placed UAE on the 'grey list', placing them under heightened monitoring due to 'strategic deficiencies' in their AML/CTF regime. In recent months the UAE have taken significant steps to be removed from the 'grey list' and last month the [Financial Times reported](#) the FATF said that the UAE had "substantially" introduced compliance measures needed for its removal from the list of countries under enhanced monitoring.

The recent revisions to the Rules reflect UAE's ongoing commitment to combat money laundering and their progress in improving compliance with FATF standards were acknowledged by the global financial crime watchdog in a [follow-up report published July 2023](#). As a next step, the [FATF stated it would conduct on-site visits to verify the proposed changes would be sustained](#). The expectation seems to be that the UAE will follow the steps of other jurisdictions including the Cayman Islands, Panama and Albania which were all removed from the list following successful on-site visits.

The new rules are effective immediately and will be relevant to:

all firms subject to the provisions in the AML Rulebook, including authorised firms in the financial services sector and Designated Non-Financial Businesses and Professions.

Separately, the UAE is also in their final stages of developing stablecoin laws. It is hopeful that their progressive approach will promote greater adoption of virtual assets while ensuring transparency and accountability.

By K Kim and T Masters