

The State of Global Crypto Assets Regulation



Understand the current state of crypto asset service provider regulation and how organizations can prepare to thrive in a future of proper oversight.

The Current Risks of Cryptocurrency

Since the introduction of cryptocurrency, several high-profile failures have challenged the stability and reliability of using ones and zeros as commercial currency, including those by companies such as Mt.Gox, QuadrigaCX, Bitfinex/Tether, Coincheck, Cryptopia, and—most recently—FTX who have all made headlines for their lack of custodial controls on behalf of their customers.

Because of that combined legacy, other companies and individuals still involved in exchanging crypto assets face several risks. Though these can vary depending on each party's specific role and their activities within the crypto ecosystem, current common risks include those regarding:



Market Volatility

The values of crypto assets such as Bitcoin and Ethereum are known to fluctuate significantly within short periods, exposing individuals and companies to potential losses if the market moves against their positions.



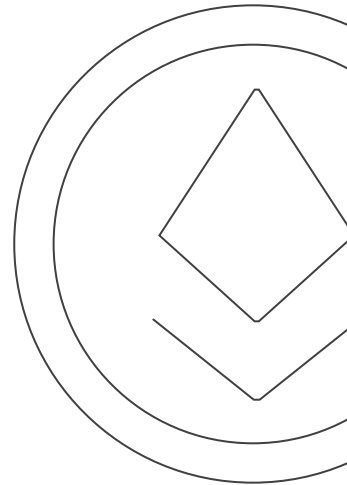
Security

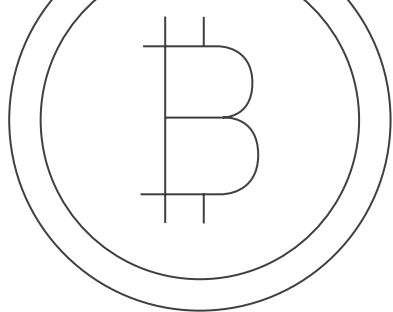
Because cryptocurrencies are digital assets, they remain vulnerable to cyberattacks—such as hacking, phishing, and malware—that can lead to loss or theft.



Regulatory and Compliance

The regulatory environment for crypto assets already varies across jurisdictions, and as it continues to evolve, companies involved in exchanging crypto assets must navigate compliance requirements related to anti-money laundering (AML) and know customer (KYC) regulations or risk legal and reputational consequences.





Operations

Crypto asset exchanges rely on their systems, infrastructure, and processes, so any failures, outages, or technical glitches can disrupt trading activities and impact customer experience.



Counterparty

As third-party service providers, crypto exchanges or custodians introduce counterparty risks, making it essential to assess their reputation, security measures, and regulatory compliance to ensure the safety of funds and assets held with them.



Liquidity

While it can vary significantly for certain crypto assets, low liquidity can impact the ability to buy or sell assets at desired prices and may result in slippage or difficulty in executing trades.



Scams and Fraud

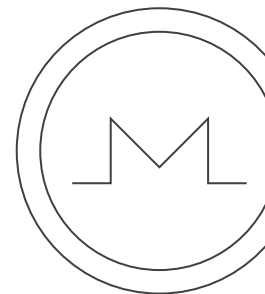
The crypto industry has already seen instances of scams and fraudulent projects—including Ponzi schemes.

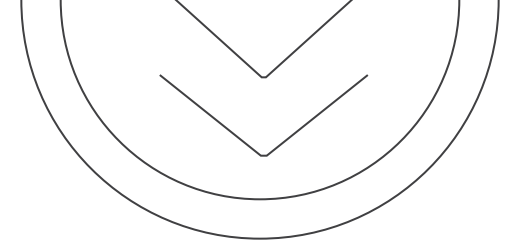


Lack of Consumer Protection

Unlike traditional financial systems, the crypto ecosystem generally lacks the mechanisms that would protect consumers in the event of fraud, theft, or disputes, making the recovery of lost funds or legal recourse challenging.

Industry individuals and companies must educate themselves about these risks, implement robust security measures, stay informed about regulatory developments, and carefully choose their service providers to mitigate the potential risks associated with exchanging crypto assets.





The Drivers for Crypto Oversight and Regulation

While these risks are prevalent, there are still benefits for those that have faith in brand-new currencies and the technologies that are enabling digital assets and web-native services. Still, the intense initial furor around these financial transactions sans traditional banking intermediaries has largely died down, as it appears many are waiting for crypto to achieve a level of market acceptance that will only occur if the industry embraces proactive responsibility regarding risk, compliance, and system integrity.

Reinforcing the regulatory and governmental oversight that exists for financial services providers of all types is more essential than ever, and through the establishment of appropriate regulations for crypto assets, the way will be paved for meaningful modernization—and security—in banking, payments, and broader financial market infrastructure in the following aspects:



Investor Protection

Regulatory frameworks aim to protect investors by establishing rules and safeguards to ensure transparency, fairness, and accountability in the crypto market, which should help curb investor exposure to fraud, market manipulation, and security breaches.



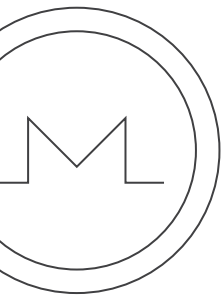
Market Integrity

Measures such as AML and KYC requirements are crucial in deterring criminal activities and promoting a more secure environment for crypto transactions.



Consumer Confidence

In setting standards for asset custody, data protection, and customer support, regulations provide a level of assurance to users that their funds and personal information are protected, and that increased confidence can also contribute to broader adoption and acceptance of crypto assets.



Systemic Risk Mitigation

The crypto market's interconnectedness with traditional financial systems necessitates similar regulatory oversight to mitigate systemic risks, as cryptocurrencies' price volatility and potential impact on financial stability require measures to monitor and address any potential threats to the broader economy.



Innovation and Collaboration

Not only can clear and well-defined regulations create a predictable and stable environment that attracts legitimate players and encourages responsible innovation, but because they'll help legitimize the industry and build trust among traditional financial institutions, regulation can also pave the way for increased association and integration.



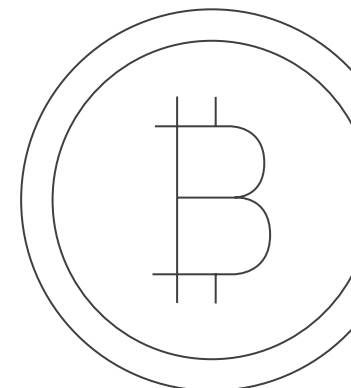
Worldwide Harmonization

Given the borderless nature of cryptocurrencies, global standards are crucial, as inconsistent or fragmented regulations across jurisdictions can create regulatory arbitrage and hinder cross-border activities. By establishing common standards and frameworks, regulation can promote interoperability, cooperation, and seamless operations in the global crypto ecosystem.



Financial Inclusion

Decentralized financial services (Defi) and native web-based platforms (web3) products and services can enable reach to the world's un/under/poorly banked provided that essential financial crimes compliance (FCC), governance controls as well as inherent privacy protections are implemented to protect consumers (individuals, businesses, households) that need access to basic, equitable and secure financial services and products.



The case is clear—well-designed and balanced crypto asset regulation is necessary to address not just these needs, but to solidify the long-term stability and growth of the crypto industry

A Survey of Current Government Regulations for Crypto Asset Service Providers

That being said, several jurisdictions around the world have already implemented or proposed regulations specifically addressing crypto assets and markets. Here are some notable examples:



Switzerland

Switzerland has taken a principle-based approach and addressed crypto specifically through the Financial Market Infrastructure Act (FMIA) and the Anti-Money Laundering Act (AMLA), which provide guidelines for crypto-related activities and offer regulatory clarity.



Japan

Japan has been at the forefront of crypto asset regulation since recognizing Bitcoin as legal tender in 2017, and its Payment Services Act and Financial Instruments and Exchange Act regulate crypto asset exchanges and establish requirements for licensing, cybersecurity, and customer protection.



Singapore

Singapore has implemented the Monetary Authority of Singapore (MAS), which oversees the crypto sector and has also introduced the Payment Services Act that covers various activities related to cryptocurrencies, including digital payment tokens and cryptocurrency exchanges.



South Korea

South Korea has implemented regulations to address anti-money laundering and consumer protection concerns in the crypto market—the country requires cryptocurrency exchanges to comply with certain AML regulations and obtain information security management system (ISMS) certifications.



Malta

Known as the “Blockchain Island,” Malta has enacted a comprehensive regulatory framework for crypto assets, including the Virtual Financial Assets Act (VFAA) and the Malta Digital Innovation Authority Act (MDIA), which provide a legal framework for initial coin offerings (ICOs), cryptocurrency exchanges, and related services.

Crypto Regulation Efforts in the United States

As for America, the United States has not yet adopted a comprehensive federal regulation specifically dedicated to crypto assets; however, various regulatory agencies have been actively involved in overseeing and regulating aspects of the crypto industry to this point.

Some of these key players related to crypto assets in the United States include:



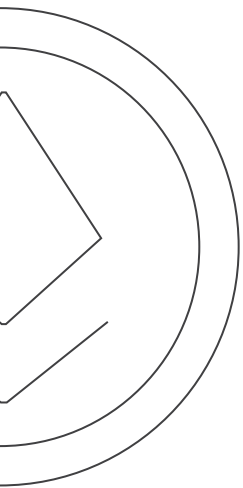
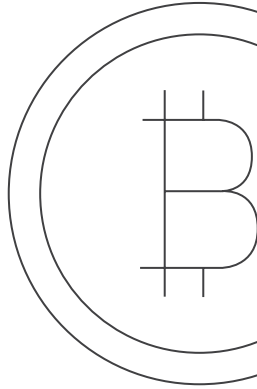
Securities and Exchange Commission (SEC)

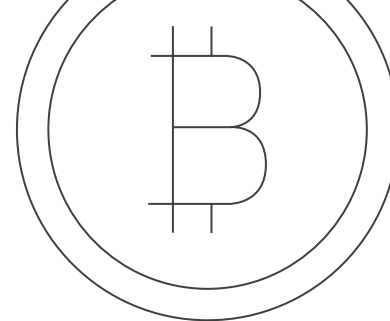
The SEC has been actively involved in regulating cryptocurrencies and Initial Coin Offerings (ICOs) under existing securities laws, having taken the position that many tokens offered in ICOs are considered securities and are therefore subject to securities regulations (unless they meet specific criteria to be classified as utility tokens).



Financial Crimes Enforcement Network (FinCEN)

A bureau of the U.S. Department of the Treasury, FinCEN has provided guidance and regulations regarding the AML and KYC requirements for virtual currency businesses, and they also require those dealing in virtual currencies to register as Money Services Businesses (MSBs) and comply with AML/CFT regulations.





Commodity Futures Trading Commission (CFTC)

The CFTC has regulatory oversight over cryptocurrencies classified as such, and it has also asserted jurisdiction over fraudulent activities and market manipulation related to crypto derivatives and virtual currencies traded on commodities exchanges.



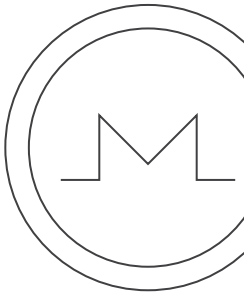
Internal Revenue Service (IRS)

For tax purposes, the IRS treats virtual currencies as property and requires taxpayers to report transactions involving cryptocurrencies and pay taxes on capital gains or losses.

In New York, the BitLicense regime requires virtual currency businesses operating within the state to obtain a license, and some other U.S. states have also introduced their own regulations or licensing requirements for crypto-related businesses. Similar new regulations or legislation are still being introduced, and those in place may yet evolve.

Pending and Proposed legislation in the US:

- Digital Asset Market Structure Bill
- Crypto Asset National Security Enhancement Act
- Responsible Financial Innovation for the 21st Century Act
- Clarity for Payment Stablecoins Act



New Regulation in the EU - Key Provisions of MiCA

Now in effect, MiCA is a comprehensive framework for crypto assets that is divided into three separate categories:



Each category carries specific regulatory requirements and provides clarity on the legal status of different types of digital assets, and entities that fall under any of the category purviews must adhere to specific prudential, conduct of business, and governance requirements to ensure market integrity and investor protection, including mandates regarding:

- Disclosure of comprehensive information to investors and regulators
- Capital adequacy
- Risk management
- Custody of assets
- Transparency
- AML and counter-terrorism financing (CTF) measures

For stablecoin issuers, MiCA is a bit more complex. Not only must issuers of stablecoin—or cryptocurrencies pegged to stable assets such as fiat currencies—obtain authorization before offering services, but the framework also includes additional requirements for these assets regarding specific capital, investor protection, and reserve asset composition requirements.

That being said, all entities authorized under MiCA will benefit from a “passporting” mechanism that allows them to operate across EU member states without the need for additional authorization. This measure aims to facilitate cross-border activities and enhance market integration within the EU while protecting investors, promoting innovation, and harmonizing the regulatory landscape across the EU.

Prepare for the Regulated Future of Crypto Assets Service Providers

The introduction of MiCA by the European Union marks important progress toward establishing a comprehensive regulatory framework for cryptocurrencies and digital assets—the new regulation will provide the kind of legal certainty and conducive environment for sustainable growth that the rapidly evolving crypto market needs.

But further governing oversight of the crypto assets service provider industry is coming, and organizations should prepare now so as to be ready to assert compliance with robust controls that operate consistently. Using MiCA as a guide, here are some measures to consider now and into 2024:

Assess Your Activities	Determine now which aspects of your business fall under the scope of MiCA—including activities such as offering crypto assets, operating a trading platform, or providing custodial services—as understanding the specific obligations and requirements relevant to your business will help you prepare for compliance.
Conduct a Readiness Assessment	Readiness assessments will help you better understand how robust your current controls that support your organization’s governance framework, risk management processes, and internal policies and procedures, as well as where you should improve them to manage risks and ensure compliance with applicable regulations.
Document Compliance Activities	Develop or update your compliance documentation—such as policies, procedures, and risk assessment frameworks—to reflect the requirements of MiCA or any future regulations, and document your efforts to implement and maintain compliance measures, as these records may be necessary for regulatory audits or inspections.

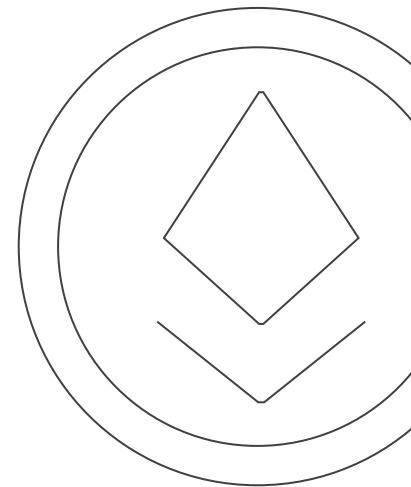
Perform Security and System Audits	<p>Because MiCA will include provisions related to the security and operational aspects of crypto asset service providers, you may want to consider auditing the adequacy of your implemented security measures, data protection practices, and system controls to ensure appropriate safeguards are in place to protect customer funds, prevent unauthorized access, and maintain the integrity of the crypto asset infrastructure.</p>
Complete AML/KYC Compliance Audits	<p>MiCA will impose compliance obligations on crypto asset service providers regarding AML and KYC, so you may want to go ahead and verify that your organization has implemented and maintained appropriate procedures, which may involve assessing customer due diligence processes, record-keeping practices, and compliance with reporting requirements.</p>
Enhance Data Protection and Privacy	<p>Evaluate your data protection and privacy practices to ensure they comply with relevant regulations, such as the General Data Protection Regulation (GDPR) in the European Union. Assess how you handle customer data, obtain consent, and secure personal information in accordance with applicable data protection laws and make improvements where necessary.</p>
Assess Climate Impact	<p>In response to proof-of-work consensus algorithms in cryptocurrency-based distributed ledger technology, MiCA includes provisions that crypto companies selling tokens on the continent disclose their environmental impact—to understand yours, this may require an environmental impact assessment.</p>
Engage Legal Experts	<p>Seek guidance from legal professionals experienced in cryptocurrency regulations to understand the specific requirements and implications of MiCA on your business, as they can provide tailored advice and assist you in developing a compliance strategy.</p>

Moving Forward with Crypto Assets

Though crypto asset technology has proven itself relevant, useful, and scalable to enhance digital life, it appears the adoption curve has reached a critical milestone that necessitates further regulation and protections to achieve further acceptance.

To prepare for that future, crypto asset service providers must implement robust security protocols, as well as scalability and risk management measures to mitigate the well-established risks of cryptocurrency, while individuals involved in the market must take precautions to secure their wallets, private keys, and digital assets, including multi-factor authentication and cold storage solutions.

Any future regulations will likely encourage greater acceptance, which will enable more accountability and avenues for competitive advantage. But organizations taking pains to prepare now may desire a helping hand to do so, and in that, Schellman can help. As part of [our dedicated Crypto and Digital Trust practice](#), we help our clients demonstrate their accountability to crypto-related technologies. For more information on how partnering with Schellman can help your company ride the next wave of cryptocurrency acceptance, [contact us](#).





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www.schellman.com

4010 W Boy Scout Blvd

Suite 600

Tampa, FL 33607

1.866.254.0000

Outside of the United States,
please dial: +1.813.288.8833