

Legal

Cyprus

Contributor



Andri Michael

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Savvina Miltiadou

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Cyprus: Blockchain

1. Please provide a high-level overview of the blockchain market in your jurisdiction. In what business or public sectors are you seeing blockchain or other distributed ledger technologies being adopted?

The Cyprus government published its National Blockchain Strategy ("NBS") in May 2019, with the core aim to promote the development of the blockchain technology through innovation and the cooperation of the public and private sector. The government collaborated with various entities, both in the public and private sector, in order to identify the needs of the market and committed to implement the NBS, in order to enter into the new era of digitalisation. Further, Cyprus has signed the European Blockchain Partnership and the 'Declaration of the Southern Mediterranean Countries on Distributed Ledger Technologies to empower the cooperation with parties abroad.

Blockchain is mainly popular in projects of the financial services market, including among others, crypto-related projects. Currently, there are nine crypto-asset service providers registered with the Cyprus Securities and Exchange Commission, including crypto-exchange platforms.

Further, blockchain technology is being used by entities involved in the finance and regulatory tech space, know your client procedures and record keeping transactions. The adoption of the European Union Markets in Crypto-Assets Regulation (MiCAR) and the Distributed Ledger Technology Pilot Regime, is expected to establish new businesses with blockchain as the underlying technology.

2. Please outline the principal legislation and the regulators most relevant to the use of blockchain technologies in your jurisdiction. In particular, is there any blockchain-specific legislation or are there any blockchain-specific regulatory frameworks in your jurisdiction, either now or envisaged in the short or mid-term?

Currently, there is no specific legislation governing the application and use of blockchain per se and therefore, there are no specific rules to be followed or any authorization requirements, when applying the blockchain

technology.

The Anti-Money Laundering Law

The Anti-Money Laundering Law, which implemented in February 2021 the 5th Anti-Money Laundering Directive of the European Union, introduced for the first time cryptoassets and cryptoasset service providers into Cyprus legislation. According to the Anti-Money Laundering Law, a crypto-asset service provider providing services relating to crypto-assets, pursuant to the provisions of the Anti-Money Laundering Law, is obliged to be registered with the Cyprus Securities and Exchange Commission unless it is a crypto-asset service provider established and registered in a member state of the EU.

CySEC, given its "technologically neutral approach" in assessing innovation, both in the case of CASPs and in the case of services failing under the existing regulatory framework will evaluate the technology used and more specifically, the risks associated with the use of such technology.

European Union Markets in Crypto-Assets Regulation

The European Union Markets in Crypto-Assets Regulation (MiCAR) was adopted in April 2023, aiming to regulate crypto-assets outside the scope of the existing financial services framework, i.e. asset-reference tokens, e-money tokens, and utility tokens. In addition, MiCAR establishes uniform rules for the licencing and operation of crypto-asset service providers in relation to services offered for crypto-assets within the scope of MiCAR. Since MiCAR is a regulation, it is directly applicable to all member states of the European Union, leading to legal certainty and security. It is expected that the existing national rules will be replaced by the provisions of MiCAR.

Regulators

The main Cyprus regulatory bodies regarding the use of blockchain in the financial services industry are the Cyprus Securities and Exchange Commission and the Central Bank of Cyprus. Both regulators, supervise companies falling under their regulatory ambit and use the blockchain technology during their operations.

Further, another important stakeholder is the Deputy Ministry of Research, Innovation and Digital Strategy,

responsible to develop and implement a national digital policy in Cyprus and to participate in the establishment of an enabling ecosystem for private and public use cases of blockchain.

3. What is the current attitude of the government and of regulators to the use of blockchain technology in your jurisdiction?

The Cyprus government embraces the introduction of blockchain technology and there is the willingness to adopt the necessary measures to establish Cyprus as a Blockchain hub and facilitate the development and application of Blockchain technology.

Certain local authorities gradually begun to use blockchain for organizational purposes (e.g. issuance of certificates), the development of a platform aiming at food traceability of local and traditional products in Cyprus and the deployment of blockchain technology in the electricity market in Cyprus.

4. Is there a central bank digital currency ('CBDC') project in your jurisdiction? If so, what is the status of the project?

Even though the Central Bank of Cyprus is active in the discussions in relation to the application of blockchain in the banking services sector, there is not an initiative in Cyprus for the creation of a CBDC.

5. What is the current approach in your jurisdiction to the treatment of cryptoassets and decentralised finance ('DeFi') for the purposes of financial regulation?

The regulation of cryptoassets falls under the regime of 5th European Union Anti-Money Laundering Directive ("AMLD5") which was transposed in the national Anti-Money Laundering Law ("the AML Law") in February 2021. The AML Law includes key definitions relating to cryptoassets and cryptoasset service providers. According to the provisions of the AML Law, a cryptoasset is *"a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by persons as a means of exchange or investment and which can be transferred, stored or traded electronically and that is not,*

- Fiat currency, or

- Electronic money, or
- Financial instruments as defined in Part III of the First Appendix of the Law on the Provision of Investment Services and Activities and Regulated Markets".

Further, Cyprus has implemented regulations that specifically address crypto-assets, including the Cyprus Securities and Exchange Commission's guidance on the regulation of crypto-assets. The guidance provides an overview of the application of existing financial regulations to cryptocurrencies and related activities, including licensing requirements for crypto-exchanges and the treatment of crypto-assets under securities laws.

In relation to DeFi, there are no specific regulations for such protocols. However, certain DeFi protocols such as decentralised lending platforms, are accessible to Cyprus residents.

6. What is the current approach in your jurisdiction to the treatment of cryptoassets and DeFi for the purposes of anti-money laundering and sanctions?

Crypto-asset service providers are considered as obliged entities and are subject to anti-money laundering laws. The relevant AML/KYC rules are set out in the Anti-Money Laundering Law, as amended from time to time.

Pursuant to the law, crypto-asset service providers, including exchanges and custodial wallet providers, are required to verify the identity of their customers and conduct due diligence on their transactions. They must also establish internal AML/CFT policies and procedures, appoint a compliance officer, and report suspicious transactions to the relevant authorities.

Cyprus also enforces economic and trade sanctions imposed by the United Nations and the European Union. These sanctions apply also to digital assets transactions and are implemented by the Central Bank of Cyprus in collaboration with other relevant authorities.

7. What is the current approach in your jurisdiction to the treatment of cryptoassets and DeFi for the purposes of taxation?

Cryptocurrencies are not considered as a currency in Cyprus and there is no specific tax provision in place for their treatment just yet. Hence, it is expected that cryptocurrencies will be taxed based on their nature and characteristics. In effect, crypto-assets characterised as

security tokens shall be treated differently from crypto-assets characterised as utility tokens or payment tokens.

8. Are there any prohibitions on the use or trading of cryptoassets in your jurisdiction? If permitted, is cryptoasset trading common?

Many individuals trade cryptocurrencies through online exchange platforms. However, the Central Bank of Cyprus, in line with the European Union's directives, has issued warnings regarding trading in virtual currencies and hence the risk averse approach of banking institutions in Cyprus towards cryptocurrencies. It is more common to see other financial institutions, mainly falling under the supervision of CySEC, to have a more open approach to cryptocurrency trading and thus we have seen licensed investment firms trading in CFDs in cryptos and also the establishment of crypto funds.

9. To what extent have initial coin offerings ('ICOs') taken place in your jurisdiction and what has been the attitude of relevant authorities to ICOs? If permissible, what are the key requirements that an entity would need to comply with when launching an ICO?

The Cyprus Securities and Exchange Commission (CySEC) at first maintained an introvert approach towards ICOs. Through its own announcement¹, CySEC has drawn the attention to investors and firms involved in ICOs to the warnings and statements of the European Securities and Markets Authority (ESMA) on the issue. CySEC wanted to emphasize that ICOs, depending on the way they are structured, may fall within the scope of existing EU legislation.

The increasing interest for financial technology though took CySEC a step further launching its Innovation Hub giving guidance to innovative products including token offerings that fall within the existing regulatory framework and thus under its supervision.

There have been cases where Cyprus companies have been used for initial coin offerings, mainly utility token offering not falling within the existing regulatory framework, but yet again to a limited extent.

An entity offering and/or selling cryptoassets, including an initial offering, must get registered with CySEC as a CASP.

Further, an entity when launching an ICO should, among others, consider very carefully:

- Whether tokens issued are considered securities or financial Instruments under MiFID II and generally MiFID II compliance;
- Whether it falls within the provisions of the Prospectus Directive;
- Whether it may qualify as a licensed investment scheme;
- Compliance with legislation on Anti Money Laundering (AML) and GDPR;
- Possible tax implications for the parties involved.

Footnote(s):

¹ CySEC announcement dated 15.11.2017

10. Are there any legal or regulatory issues concerning the transfer of title to or the granting of security over cryptoassets?

The establishment of the ownership of tokens and virtual assets is one the most important issues to be addressed. Additionally, the recognition of blockchain technology within the sphere of existing regulations and laws is a potential issue which may arise during the transfer of a title to or the granting of security over tokens and virtual assets.

11. How are smart contracts characterised within your legal framework? Are there any enforceability issues specific to the operation of smart contracts which do not arise in the case of traditional legal contracts?

There is not a definite opinion to what extent smart contracts are enforceable under Cyprus law, since there is not a legal framework or precedent by the courts regarding the treatment of smart contracts. However, being a common law jurisdiction, it is expected that Cyprus will adopt the position of other common law jurisdictions, with regards to smart contracts, their application and enforceability.

In general, admissibility issues may arise due to characteristics of smart contracts. Since smart contracts are codified and automatically performed, it is difficult to prove intention of the parties. Additionally, issues of revocation, frustration or breach of contracts remain to be addressed.

12. How are Decentralised Autonomous

Organisations ('DAOs') treated in your jurisdiction?

The operation of DAOs is not governed by any specific national regulations, other than the ones applicable to the token issuance and crypto-assets under the AML regime. In effect, the use of DAOs within the national financial ecosystem is not so common given the absence of traditional governance rules.

13. Have there been any governmental or regulatory enforcement actions concerning blockchain in your jurisdiction?

There have not been any important judicial decisions on the use of blockchain, smart contracts or the use of such technology at large. The current ongoing disputes relate mainly to crypto claims as a result of fraud and mismanagement of wallets.

14. Are there any other generally-applicable laws,

case law or regulations that may present issues for the use of blockchain technology (such as privacy and data protection law or insolvency law)?

There is a considerable number of laws that must be amended to implement the use of technology within their sphere such as laws on public offerings, companies' law, AML procedures, laws on capital markets etc.

There are other laws also that create challenges for the use of blockchain. Any application of blockchain technology must be GDPR compliant for example.

15. Are there any other key issues concerning blockchain technology in your jurisdiction that legal practitioners should be aware of?

In the absence of a specific legislation on blockchain, it is important to ensure that blockchain is used in the sphere of existing legislation, to establish more certainty and a competitive edge to the country.

Contributors

Andri Michael

Partner – Financial Services & Funds Department

andri.michael@kinanis.com



Savvina Miltiadou

Senior Associate Lawyer – Financial Services & Funds Department

savvina.miltiadou@kinanis.com

