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On the Legal Nature of Cryptoassets: Waiting for Godot?

3 Apr 2019 | Filippo Zatti

What is the true legal nature of cryptoassets? This is a question that has been echoing in my mind since I read an inspiring paper about blockchain lexicon by Angela Walch. And this is also one of the two main issues that I address in my recent academic article entitled "Entangled in Cryptoasset's Legal Nature and Governance: Searching for Clear Boundaries or Working for their Removal?"

I drafted the paper during my visit to the Edinburgh Law School where I was invited by Professor Emiliós Avgouleas and I could work with the researchers of the Blockchain Technology Laboratory. This opportunity was particularly useful for learning what cryptoassets really are for cryptographers and how blockchains actually work. My aim was to verify whether the different structure of blockchains – permissionless or permissioned – can affect the legal nature of cryptoassets and, if so, affect blockchain governance. These are not yet settled questions. Rather, it is desirable that, in each jurisdiction, in-depth legal research be done to verify whether the existing legal categories would be appropriate and adequate to be applied in the crypto space. Or whether, if otherwise, we need to untangle the skein of different interpretations through the identification of new legal categories. This is an inevitable knot that must be untied if we are to shape an effective and functional governance of the crypto space. As Low & Teo have stated – correctly, in my opinion – 'the lack of attention to private law rights hampers regulatory efforts, as it seems obvious that regulating an obscure and enigmatic asset must pose greater challenges than regulating well-established asset classes with clearly defined legal characteristics'.

If we do not succeed, we could see unintended negative effects from an incorrect categorization attempt. In a report of the French Minister of Finance, at least three of these effects are mentioned: specifically, fixing legal rules that would quickly become inadequate due to the rapid development of the technology, being mistaken about the true nature of the object being regulated, and orienting innovation efforts towards escaping regulation.

As a consequence, cryptoasset governance – or perhaps, more correctly, crypto space governance – is the second issue on which I focus my analysis. Legal scholars have proposed a wide range of adoptable theoretical solutions. These differ according to the grade of separation that is recognized between crypto space and the 'physical world'. We start from the complete separation of those 'two worlds' in the definition of a Cryptolaw (Carla Reyes), pass through the typical legal frameworks used in the case of autonomous systems (named here appropriately Lex Cryptographia by Aaron Wright & Primavera de Filippi), until we reach the far opposite side: traditional state-based regulation, although limited to payment cryptoassets (David Fox).

After paying attention to the judicial cases and the special regulatory framework already in force in a few jurisdictions, my analysis is then restrained to 'financial' cryptoassets. This was occasioned by the recently enacted Virtual Financial Assets Act (VFAA) in the Republic of Malta. As an EU member state, Malta's cryptoassets regulatory scheme can be of particular interest for in-depth analysis in anticipation of EU legislative provisions. The VFAA is not conclusive in the sense that it does not fully qualify the legal nature of a cryptoasset. It aims only to identify whether

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cryptoassets are encompassed under EU legislation and the corresponding national legislation, under the VFSA itself, or are otherwise exempt. However, to reach that goal, Malta Financial Services Authority needs to process an empirical Financial Instrument Test, which reminds me – even if not properly – of the Howey Test applied in the US by the Securities and Exchange Commission in the face of a lack of legislative intervention by the Congress.

The dramatic dispersal of cryptoassets that is sought through Initial Coin Offerings and 'exchange platforms' reminds one of the tulip bubble and the need to guarantee investors against fraud and scams. But this time seems different. Blockchain is something brand new due to its ubiquitous nature and the chameleon-like legal status of its output: cryptoassets. It is with this awareness that, in the conclusion of my article, I formulate a proposal in terms of address and method to be brought to the attention of legal scholars and policy makers.

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