

Navigating the Global Regulatory Trends and Developments in Digital Assets



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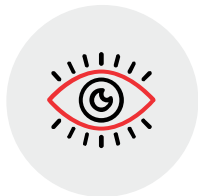
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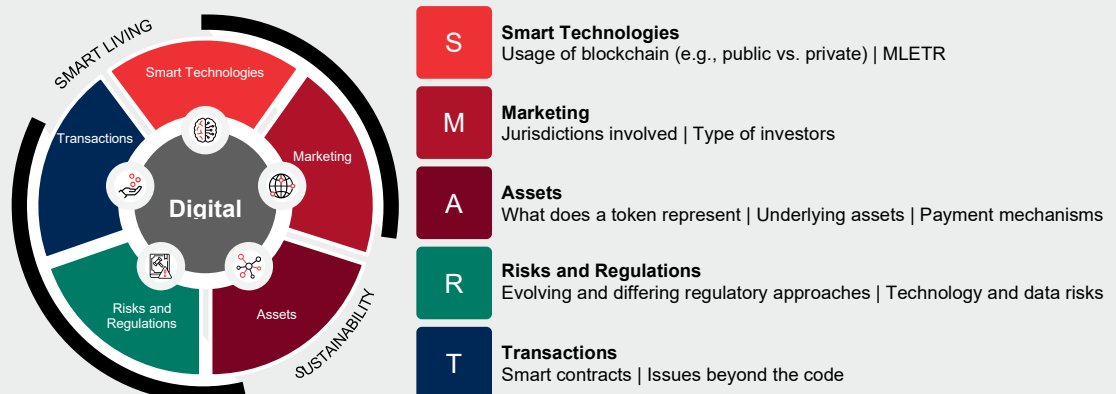
Overview

Across all discussions of blockchain technologies and tokenisation, a recurring point is how regulations play a part in fostering the right environment for unlocking their potential. Existing regulations provide fundamental principles and stable starting points to develop blockchain and tokenisation in the traditional financial spaces, such as for asset management; but what exactly does that entail and what are the actionable points?

In the last few years, we have had a chance to work with financial institutions to look at how to actualise the potential of tokenisation and use of digital assets. Universally, there is no standardised set of laws you can refer to for digital assets and tokenisation, and there is no one-sized fits all approach, but there are some questions you can ask yourselves when navigating the regulatory and legal issues using the acronym SMART, as will be broken down and explained in 5 key takeaway points.

The SMART Approach to Navigating Regulatory and Legal Issues in Digital Assets

Figure 20: Summary of the SMART approach, prepared by Baker McKenzie Wong & Leow.





Key Takeaways

Takeaway 1:

S: Smart technologies.

When approaching a new tokenisation project (or even reviewing an existing one) the first question to ask is what exactly is the technology being used. For instance:

1. What technologies are you utilising in the digital asset / tokenisation project?
2. What are the legal issues based on the technology being utilised?
3. What does your technology do, and will it allow you to fall within the ambit of the legal definitions in your jurisdiction / other jurisdictions?

Using blockchain technology as an example in such an application:

- If you are using blockchain technology in your tokenisation project, one legal point to consider is the Model Law on Electronic Transferable Records. Fundamentally, a blockchain is a ledger – a record of certain transactions. Legal issues that one might consider are: is it a legal record? Will it be recognised if used in court?
- It is important to look at the **structure and function** of your blockchain. Taking a private blockchain for example – it may allow the person who is running the network to change the records (i.e., not immutable), and this would raise questions about reliability in assessing the legal status of the ledger.
- In this regard, the Electronic Transactions Act 2010 used to only recognise electronic records, but since 2011, it also recognises electronic transferable records and instruments (such as promissory notes). This represented an effort to follow the Model Law on Electronic Transferable Records, in the hopes that globally there will be a convergence to follow the same, and ultimately set up a degree of cross-border recognition.
- In terms of identifying trends, the trajectory here appears to be the **creation of the right conditions to facilitate ours and our counterparts' digital economies**. In this regard, we understand that G7 countries are now looking at adopting this. To the end that our counterparties also adopt these, we can also spur third parties to adopt the same.

Taking a step back from the example, the key takeaway is to map out discretely the **technologies utilised**, and the **corresponding legal issues**, and what **regulatory trends** might be of relevant considerations.

Takeaway 2:

M: Market and Marketing.

The next questions to ask are in relation to which markets you intend to launch the project, to whom you will be marketing, and what activities will be carried out. As alluded to in other sessions, there is no harmonised approach to assess these regulations, and this most likely will not be developed anytime soon to a point where a single approach will be acceptable across all, or even most, jurisdictions. Hence, there will likely be regulatory issues triggered, and there is a need to undertake various analyses. Some questions to ask are:

1. Where you have a tokenised asset, who are you going to offer it to? Is it going to be purely institutional clients, high net worth clients, or even the retail public?
2. Where are these persons located? Will the offerings and marketing be done on a local, or cross-border basis?
3. In the market, how will the regulators view the technology being utilised, and the digital assets being offered?

As an example, if the tokenised assets are intended to be offered overseas, a couple of things commonly considered in our experience are:

- There is room to check if you can service persons from another jurisdiction as long as you are not there on the ground, such as on a reverse solicitation basis; or use a local distributor or partner that is adequately licensed to market.
- If there are prospectus or registration requirements, you could consider whether there are exemptions for certain investors, such as sophisticated investors or institutional investors.
- There may be specific digital assets laws that catch all kinds of digital assets, or depending on the characteristics of the tokenised assets, it could also be caught under security regulations – both may have differences in rules and regulations.

To this end, it would be helpful to have a partner or consultant who has a **deep expertise and a strong relationship** with regulators to help figure out the current approach, and whether there will be changes to the regulations as well.

Takeaway 3:

A: Assets.

Hinted at M above, the characteristics of and rights attached to the digital asset plays an important role in understanding what regulatory requirements apply.

1. **What asset does the token represent? How is it looked at and characterised from a legal perspective?**
2. **What are the underlying payment mechanisms (e.g., delivery versus payment, real time atomic settlements)? How would these payment mechanisms work together with your token?**

A digital token could represent various asset classes – bonds, funds, and bank liabilities to name a few – or it could be a natively issued asset. **The "asset" question requires you to know how the regulators look at the digital token based on the technology itself and the underlying structure of the tokens or even the asset it represents.** The key idea is to understand the same token from the lenses and perception of the various jurisdictions.

From a payments perspective, the payment mechanisms may also trigger local regulations. For instance, in many jurisdictions, e-money and digital currencies are regulated too, and the question then is whether the payment mechanisms associated with your digital assets would trigger these payments regulations in a certain jurisdiction, and whether it would do the same in another jurisdiction.

To this end, it is **helpful to keep in mind the existing rules and regulations surrounding traditional financial assets.** Let's say that you intend to offer tokenised funds on a cross-border basis – the starting point will be the usual rules as the principles will still apply, just that there may be an overlay with regard to the digital element.

Takeaway 4:

R: Risks and Regulations.

Risks and regulations is an important area as blockchain technology and tokenisation has introduced novel risks and regulatory concerns to the fray, which are also constantly changing as new benefits are uncovered and potential is unlocked. Hence it is important to ask:

1. **What are the various risks that need to be addressed? Examples that can be considered are: cross-border risks, technology risks, and also data risks.**

Laws are constantly changing to address new products and services and ways of distribution – this can be seen through Project Guardian where various stakeholders are brought together for the Monetary Authority of Singapore to assess whether regulatory changes need to be made. If you had begun a digital assets project a year ago, you might be due for a regulatory review for changes to the relevant laws and regulations.

Takeaway 5:

T: Transactions.

Blockchain technology is generally safe and reliable – but there is still a risk, as seen from the hacks of digital asset wallets and exchanges. There is a need to assess how these risks can be addressed based on the technologies used and transactions carried out. Based on our experience, these might be questions to raise:

1. What is the transaction about?
2. Does it involve smart contracts? If so, what are the considerations beyond just the codes?

Using smart contracts as an example: if you are utilising smart contracts for the automation of certain deterministic functions, it is necessary to consider how the courts have viewed it.

- There is no such thing as a simple contract – there is a whole set of written and common laws that govern contracts. The same applies to smart contracts.
- As it pertains to smart contracts, in recent years, we have seen the courts focus on the mistakes surrounding smart contracts. The question is whether a mistake should be recognised, and therefore the transaction undertaken should be unwound and made voidable.
- It would then be necessary to consider if this affects the viability of deploying smart contracts in your ecosystem and the purposes for which it is utilised, especially if the transactions could trigger such points of law.
- In this space, there are also trends to look at for case law, the main one here being that a common law doctrine of the law of mistake is being applied onto smart contracts. One thing that can be gleaned by the application of a common law concept to the digital assets space, is that it reflects the **regard to be had to the fundamental regulatory framework people are already used to**.

These are issues that asset managers should keep in mind and account for in their approaches for their projects.

As might already have been gleaned from the SMART approach above, the regulatory takeaway is that the **fundamental frameworks still apply**, and one just has to apply it alongside the necessary overlays. Generally, the tokenisation and digital asset projects asset managers and other financial institutions are pursuing can in fact be done – it is just a matter of looking into the relevant frameworks, and executing the projects within applicable legal boundaries. **To this end, legal partnerships and cooperation are crucial**.
