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A series of briefings that take a "bite-size" look at international trends in different jurisdictions, drawing on Baker McKenzie's expert financial services practitioners.

The approach to cryptoassets in property law and regulation

This edition takes a bite-size look at the property law and regulatory status of cryptoassets in the United States, UK, Australia, Singapore, Switzerland and Hong Kong.

Although cryptoassets generally do not fall within the traditional criteria for property, most jurisdictions are slowly edging their way towards formally recognizing this new category of property — with the exception of tax authorities that have been early movers in order to protect the tax base. This growing recognition of cryptoassets as property is based on an incremental extension of relevant principles and a large dose of pragmatism as the phenomena of cryptoassets acquires more importance in the economy. The classification of cryptoassets into the three categories of security/asset, payment or utility token has been widely adopted on which regulatory consequences follow. What does differ of course, is how each regulator approaches its analysis of any given token depending on the terms of their national securities and payments laws. This is an area where internal bodies such as the Financial Stability Board and the International Organization of Securities Commissions have important roles to play, particularly over mitigating the risks posed by this new asset class.

United States

Cryptocurrencies are subject to different and sometimes overlapping legal and regulatory regimes in the United States. These regimes may include currency, securities, commodities or general intangibles, depending upon the particular circumstances of the inquiry. While it is not yet settled law, cryptocurrencies are recognized as personal property in a variety of contexts.

Cryptoassets as property

The U.S. Supreme Court has long held that property rights are a creature of state law. Property rights are not created by the federal constitution, but rather, "individual entitlement [to property] is grounded in state law", see *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 430 (1982). At the statutory level, the State of Wyoming recently enacted a law that expressly recognizes digital assets, including cryptocurrencies, as intangible personal property. See W.S. SF0125 which was effective 1 July 2019. In most other states it remains to be argued that cryptocurrencies meet the criteria established by the courts for the recognition of a property interest. In connection with a dispute over property rights concerning Federal Aviation Administration issued Supplemental Type Certificates, the Ninth Circuit Court of Appeals articulated the three criteria under California law: (i) an interest capable of precise definition; (ii) capable of exclusive possession or control; and (iii) where the claimant has established a legitimate claim to exclusivity, see *G.s. Rasmussen & Associates, Inc. v. Kalitta Flying Service, Inc.*, 958 F.2d 896 (9th Cir. 1992). It has been argued that cryptocurrencies meet these criteria for establishing personal property rights: once secured to the blockchain, a cryptocurrency (or more precisely, the ledger entry reflecting the transfer of the cryptocurrency previously received) is associated with a particular address and cannot be further transferred or reassigned without the private key for that address.

Other statutes and regulations that have been applied to cryptocurrencies presuppose that they constitute property. In one 2013 case involving online money exchangers which failed to register with the Financial Crimes Enforcement Network (FinCEN), the Maryland District Court held bitcoins to be subject to civil forfeiture under 18 U.S.C. §1960, a statute that applies to forfeiture of real or personal property, see *United States of America v. 50.44 Bitcoins*, Civil Action No. ELH-15-3692 (D. Md. 31 May 2016). In the context of bankruptcy, one court was presented with a claim by the bankruptcy trustee to avoid a prepetition transfer of bitcoin as a preference or fraudulent transfer. *In re Hashfast Technologies, LLC*, No. 14-30725-DM (Bankr. N.D. Cal. 22 February 2016), while the court did not reach the interesting issue of whether the cryptocurrency was a currency or a commodity (and therefore whether the dollar value at the time of the transfer or the substantially increased value of the bitcoin at the time of the decision could be recovered), the court did find that that the bitcoin at issue could be subject to Section 550(a) of the U.S. Bankruptcy Code that by its terms applies to transfers of property.

Regulatory perimeter

One U.S. agency has found cryptocurrencies to constitute property. In 2014, the Internal Revenue Service ruled that for federal tax purposes, cryptocurrencies are treated as property, see I.R.S. Notice 2014-21, 2014-16 I.R.B. 938 (14 April 2014). Some agencies have referred to cryptocurrencies as part of a category of "digital assets." The U.S. Securities and Exchange Commission (SEC) issued the "Statement on Digital Asset Securities Issuance and Trading" on 16 November 2018, and the "Framework for 'Investment Contract' Analysis of Digital Assets" on 3 April 2019. Both sets of guidance from the SEC use the term "digital assets" when referring to cryptocurrencies. While it may be inferred that the agency considers cryptocurrency assets to be property, the terms "asset" and "property" have distinct legal meanings.

United Kingdom

The status of cryptoassets, distributed ledger technology (DLT) and smart contracts is unclear under both English private law and financial regulation. This is not surprising given the rapid technological development in this area as law and regulation have struggled to keep up. However, given recent key developments this is now changing.

Cryptoassets as property

Under English law, personal property is either a 'chose in possession' or a 'chose in action.' English law, for example, does not expressly treat intangible bitcoins based on DLT as either. Moreover, information or data is not considered to be property in itself, nor do bitcoins create contractual rights against anyone — albeit HM Revenue & Customs has said cryptoassets are property for the purposes of inheritance tax.

In July 2019, the London Commercial Court, in the case of *Robertson v Persons Unknown* (case number CL-2019-000444), implicitly "recognized" bitcoin as legal property for the first time. This was on the making by the court of an interim asset preservation order to prevent stolen bitcoins from being dissipated or transferred in a hacking case following a "spear phishing" attack on an email account. The attackers had diverted most of the bitcoins to a digital wallet traced to the UK subsidiary of a well-known digital currency exchange. It was argued that the "theft" of the bitcoins had not transferred the title to the hacker and, therefore, the title could not have been transferred to the exchange. The judge accepted that this was a question to be tried. The claimant is said to have relied on the decision of Simon Thorley IJ in the Singapore International Commercial Court in *B2C2 Ltd v Quoine Pte Ltd*, [2019] SGHC(I) 03. This held that bitcoin are personal property that can be the subject of a trust and is discussed below. Additionally, the English High Court decision in *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 (Ch) was cited, which concerned the fraudulent transfer of carbon emissions allowances, and where the court upheld the claimant's claim for the value of the allowances on the basis they constituted a form of intangible property.

This autumn the UK Courts are waiting to hear from the UK Jurisdiction Taskforce (UKJT), a group chaired by Sir Geoffrey Vos, Chancellor of the High Court. Earlier this year, the UKJT published a consultation paper on the principal issues concerning the perceived legal uncertainty over cryptoassets and smart contracts that is attributed by some to a lack of confidence in this technology. Greater legal certainty might boost their use, for example, by removing doubt over the enforceability of smart contracts. An authoritative legal statement is expected shortly offering "the best possible answers" to these questions. The government will then consider whether any legislative change is necessary or appropriate.

Regulatory treatment

While the courts and the UKJT have considered their legal status generally, a taskforce comprising HM Treasury, the Bank of England and the Financial Conduct Authority (FCA) has been assessing the potential impact on financial services of cryptoassets and DLT and the appropriate policy responses. While the authorities believe this technology has the potential to offer significant benefits, their final report states they want to see regulatory action to manage the range of risks observed from financial crime, the sale of unsuitable products, market integrity and to financial stability.

As for cryptoassets, the FCA has categorized them depending on their intrinsic structure as well as their purpose. Security tokens that provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits are viewed as "specified investments" under the UK's Regulated Activities Order and potentially "transferable securities" under the EU's Markets in Financial Instruments Directive. Such cryptoassets fall within financial regulation and, therefore, within the FCA's remit, as do investment products such as derivatives contracts that reference these cryptoassets — on which the FCA is proposing a ban on retail sales. Other tokens that meet the definition of e-money under the Electronic Money Regulations also fall within regulation.

On the other hand, utility tokens that are redeemable for specific products or services, typically provided using a DLT platform, fall outside of regulation. Potentially these include "cryptocurrencies", "cryptocoins" or "payment tokens" such as such as Bitcoin and Litecoin. In contrast, "stable-coin" cryptocurrencies linked to fiat currencies are likely to constitute e-money. The FCA has published guidance that, at the very least, has the merit of setting out its approach to the regulatory treatment of cryptoassets. HM Treasury may decide to extend the regulatory perimeter to bring in additional cryptoassets that currently fall outside regulation, where they mimic specified investments and/or pose significant risks. Cryptoassets are already due to be brought within the AML/CTF regime from next year in accordance with the recommendations of the Financial Action Task Force when the UK transposes the EU's Fifth Money Laundering Directive into national law.

Australia

Cryptoassets as property

In Australia so far, there has been little guidance as to whether a cryptoasset would be recognized as property in law, though commentators have noted that in considering the Australian general law and economic tests for property, it is likely that cryptoassets such as bitcoin would constitute property. Property is generally thought about in the context of "rights over things capable of being identified." Where something does not meet the accepted indicia for property, in practice, the definition does not standstill and the indicia adapts so that a "thing" is not improperly excluded.

Regulatory treatment

In February 2019, the Australian Treasury launched a public consultation on initial coin offerings (ICOs), and called upon industry stakeholders to make submissions. The issues paper accompanying the consultation considered the current regulatory framework for cryptoassets in Australia and asked whether further regulatory measures were needed to address the risks posed by ICOs and to promote a well-functioning ICO market in Australia. Baker McKenzie's submission to the Treasury recommended a safe harbor approach for tokenized assets, tokenized securities and security tokens that are admitted to and traded on a licensed market. The consultation period has now ended and the Treasury's conclusions are awaited.

The Australian Securities and Investments Commission's (ASIC) information sheet on ICOs and cryptoassets (INFO 225) was refreshed in May 2019. This provides guidance on how the *Corporations Act 2001* may apply to cryptoassets. Under this legislation, persons dealing in financial products must hold an Australian financial services licence. Importantly, ASIC notes that each cryptoasset is to be assessed on an individual basis taking account of the cryptoasset's specific rights and features. The four most common characterizations of cryptoassets are described below, and each requires the person dealing in these cryptoassets to hold a licence and comply with ongoing obligations.

- *Interests in a managed investment scheme* (MIS) have three elements: (i) the contributions of money or assets to obtain an interest in benefits produced by the scheme; (ii) those which are pooled or used in a common enterprise to produce financial benefits (or interests in property) for those who hold interests in the scheme (e.g., using the contributor's funds to build the platform); and (iii) that the contributors do not have day-to-day control over the operation of the scheme. In certain cases, an ICO might constitute a MIS and a cryptoasset, therefore it could be an interest in an MIS.
- *Securities*: Under section 92 of the Corporations Act, securities include shares, debentures or units of shares. A cryptoasset may constitute a share where the rights attaching are similar to those usually attached to a share. For example, where there is a right for the owner of the cryptoasset to participate in the profits of the company, then the crypto-asset may be a share.
- *Derivatives*: A cryptoasset may be characterized as a derivative, where the value of the cryptocurrency is ultimately determined, derived from, or varies by reference to the value or amount of an external reference (e.g., an asset, rate, index or commodity). Asset-backed tokens that are backed by real world assets, such as oil, may in this way constitute a derivative.
- *Non-cash payment facilities*: A cryptoasset may constitute a non-cash payment (NCP) facility under section 763D of the Corporations Act. A cryptocurrency would be an NCP where a person makes payments, or causes payments to be made, other than by physical delivery of cash. It is likely that several utility tokens used for the payment for goods and services would fall to be regulated as NCP facilities under Australian financial services law.

Separately, there has been dialogue around the creation of a central bank issued Australian digital dollar, however representatives of the Reserve Bank of Australia have suggested this is not on the cards at the present time — in part because of the speed of innovation generally in the payments sphere.

[1] See "The bitcoin is property" (2014) *Australian Property Law Bulletin (newsletter)* 29 (5) APLB 94.

Singapore

The legal characterization of bitcoins and other cryptoassets has been discussed in Singapore for the past five years. Yet, it remains a vexed issue, complicated by the lack of a unifying definition of "cryptoassets" which is applied to a broad class of instruments of different functionalities. Singapore is now inching closer to some clarity in this space.

Cryptoassets as property

The decision on the first cryptocurrency case in Singapore was issued earlier this year in B2C2 Ltd v Quoine Pte Ltd (B2C2) referred to above by the English courts. Although the point was not technically disputed between parties, this decision is the first judicial reference to cryptocurrencies as property.

B2C2 was an electronic market-maker that provided liquidity on Singapore-based Quione's cryptocurrency trading platform. Due to a technical glitch, seven trades were executed in favor of B2C2 at a rate of approximately 250 times the bitcoin and Ethereum market exchange rate. These trades were executed without human intervention and B2C2's account held with Quoine was credited with proceeds from these trades. However, Quoine reversed the transactions when its CTO discovered the error the next day.

Apart from a breach of contract, B2C2 also claimed that a breach of trust had occurred when Quoine reversed the trades and disposed of its assets. To determine if there was a breach of trust, a trust first had to be established. This required certainty of intention, subject matter and object to be present. In considering the certainty of subject matter, Simon Thorley IJ commented that cryptocurrencies meet all the requirements of the classic definition of property. While cryptocurrencies are not considered legal tender, he recognized that they have the fundamental characteristic of intangible property as being an identifiable thing of value. This was not disputed by Quoine. Rather Quoine disputed the certainty of intention to create the trust. On this, Simon Thorley IJ found clear evidence of Quoine's intention to hold assets on trust for each individual member because as a factual matter, Quoine had stored the virtual proceeds for all members in an offline wallet maintained separately from Quoine's own assets. Interestingly, one wonders if a different conclusion would have been reached had Quoine chosen not to segregate its customer's assets from its own since it was not subject to regulations requiring it to do so at the time.

Regulatory treatment

The decision referred to cryptocurrencies in general but there is increasing recognition that the nature and application of bitcoins or Ethers differs from say, security tokens or utility tokens. Accordingly, such cryptocurrencies warrant different regulatory treatment.

The Monetary Authority of Singapore (MAS) has emphasized the need to hone in on the structure, characteristics of, including the rights attached to a cryptocurrency or digital token to determine if it falls within the category of a capital markets product regulated under Singapore securities regulations. Security tokens, for instance, would be subject to securities offering rules and cryptocurrency exchanges operating a market for security tokens would be regulated within the existing regulatory regime for traditional securities exchanges. New payments legislation which is expected to come into force in January 2020 on the other hand will regulate digital payment tokens (including bitcoins). Digital payment token dealing and exchange services will be licensable.

From the tax perspective, digital tokens are currently treated as a taxable supply of services. However, the Inland Revenue of Singapore has proposed exclusions from the Goods and Services Tax from 1 January 2020 for: (i) the exchange of digital payment tokens for fiat currency or other digital tokens as financial services; and (ii) the use of digital payment tokens as a means of payment for goods and services.

[2] *"it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability*."; B2C2, para. [142]
[3] B2C2, para. [142]

Switzerland

Cryptoassets as property

There is an ongoing debate about what is the legal nature of cryptoassets under Swiss private law. Among the potential classifications are chattels, energy rights recognized under the Civil Code, a form of intellectual property or data property, uncertificated securities and other *sui generis* private law rights. Arguably, however, one of the most important questions is how specific rights attaching to a token are transferred. In any event, the answer differs depending on the economic functions and rights underlying a specific token.

As in other jurisdictions, for example, in the UK as discussed above, although the language varies, a distinction exists between three categories of token:

- **Payment tokens**: These are synonymous with cryptocurrencies and are intended as a means of payment for goods or services or as a means of value transfer and do not give rise to claims against their issuer.
- **Utility tokens**: These provide access to an application or service by means of a blockchain-based infrastructure.
- **Asset tokens**: These represent assets such as a debt or equity claim against their issuer. Asset tokens contain a promise, such as a share in future earnings of a company or a project. In terms of their economic function, they are analogous to equities, bonds or derivatives. Tokens that enable the trading of physical assets on the blockchain (tokenized assets) also fall into this category.

As these classifications are not mutually exclusive, hybrid tokens may also exist. For instance, asset and utility tokens may also constitute as payment tokens depending on the rights attaching.

Payment tokens do not usually have third party rights attached to them, for instance, a bitcoin is a pure-play digital asset. They are therefore transferable without the need for written formalities under Swiss law. While property law rules will determine the type of action necessary to recover an asset unlawfully alienated from a previous owner, in many cases this will prove to be theoretical in nature due to the transnational context of most cases and the ubiquitous and final nature of blockchain transactions.

For utility tokens, which are essentially vouchers for a service, and asset tokens, which generally represent an "IOU" towards a third party, different private law rules may apply. Such tokens generally do not represent digital assets, but rather, they identify the holder of rights against a legal or natural person. This gives rise to transferability issues, as well as raising the question of whether they constitute uncertificated securities that can only be transferred in writing. While digitally certified signatures could in theory be used to transfer rights under Swiss law, currently this is not practicable to do so. The Swiss Federal Council addressed this issue in a recent consultation on amending the Code of Obligations. Under their proposals, a transfer of rights recorded on a register based on DLT would no longer need to be in written form. Such a change, if enacted, would increase legal certainty for token transfers. However, it is unknown when, or if, this amendment will be taken forward.

Regulatory treatment

There are no DLT-specific laws in force in Switzerland, and comprehensive regulation of tokens or DLT is not envisaged. Rather, the traditional, principle-oriented and technology-neutral approach of Swiss financial market regulation applies.

The Swiss Financial Market Supervisory Authority (FINMA) has published general guidance on the regulatory treatment of tokens under Swiss law, namely the ICO Guidelines (see our guide/blog post). In particular, FINMA review the economic nature of a token to determine its regulatory treatment, for instance, whether to treat it as a security. It employs the "duck test": if it looks like a duck, swims like a duck and quacks like a duck, then it probably is a duck.

FINMA follows the categorization of cryptoassets into payment tokens, utility tokens and asset tokens (as well as hybrid tokens) as described above. The regulatory consequences depend largely on the specific "tokenomics" and the rights attached to the token. However, certain general statements are possible:

- Payment tokens are not subject to prudential regulations if they are pure digital assets. They may however, be in scope of prudential regulation if they convey rights in underlying assets (such as units of gold or any other asset or basket of assets that is relatively "stable") to token holders, for instance, in the case of certain stable coins. Issuers and traders of payment tokens must comply with Swiss anti-money-laundering laws.
- Utility tokens are not generally within the scope of financial market laws. However, if a utility token additionally has an investment purpose at the point of issue, FINMA will treat such tokens as securities.
- Asset tokens may qualify as securities, with consequences for both the primary market (i.e., the obligation to publish a prospectus) and the secondary market (e.g., to trade only on licensed securities trading venues, make follow-up disclosures, etc.). They may also fall within the Banking Act, the Collective Investment Schemes Act and other relevant laws. Therefore, particular attention must be paid where there is an investment component related to an asset, or if the tokens are in some way linked to an underlying asset.

Hong Kong

Cryptoassets as property

In Hong Kong, there has been little guidance or judicial consideration as to whether cryptoassets will be recognized as "property" in law. Ownership of cryptoassets, and their transfer between private individuals is currently not subject to any legal restrictions or regulations, provided they are obtained and/or transferred in good faith. Depending on their features, cryptoassets are sometimes referred to as virtual commodities, cryptocurrencies, digital tokens or utility tokens, but none of these are expressly defined within the law. Hong Kong's Securities and Futures Commission (SFC) has adopted the term 'virtual assets' to describe this broad class of instruments, stating that "the polymorphous and evolving features of virtual assets mean that they may be, or claim to be, a means of payment, may confer a right to present or future earnings or enable a token holder to access a product or service, or a combination of any of these functions."

Regulatory treatment

That said, the Hong Kong regulators have made it clear that cryptoassets could be subject to regulation under existing regulatory regimes. These regimes may include currency, securities or futures contracts, depending on the features and characteristics of each cryptoasset. For instance, in a keynote speech in late 2018, the Chief Executive of the Hong Kong Monetary Authority (HKMA) considered the extent to which cryptocurrencies could serve as money, by measuring them against the following three benchmarks: (i) medium of exchange (i.e., whether it is generally accepted as a means of instrument of payment to facilitate the sale and purchase of goods and services); (ii) store of value (i.e., the ability to hold its value over time); and (iii) unit of account (i.e., whether it is accepted as a standard measure of value or price of goods, services, assets, liabilities, income, expenses profits and losses). From the HKMA's perspective, cryptocurrency does not satisfy the criteria of "money" primarily because of its failure to be readily accepted as a medium of exchange, its high volatility in value arising from its lack of intrinsic worth, and the difficulty in adopting cryptocurrency as a standard measure of value.

The SFC has also issued various statements to the effect that cryptoassets could, depending on their characteristics, fall within the definition of "securities" (which includes interests in a collective investment scheme), or "futures contracts". In order to allow cryptoasset-related activities to fall within the safety net offered by the existing regulatory framework, the SFC implemented certain regulatory policies in November 2018 addressing the management and distribution of cryptoassets funds or portfolios by SFC-licensed intermediaries. The SFC also launched a regulatory sandbox to explore the viability of regulating and licensing cryptoassets trading platforms.

[4] Securities and Future Commission (2018) Statement on regulatory framework for virtual asset portfolios managers, fund distributors and trading platform operators: https://www.sfc.hk/web/EN/news-and-announcements/policy-statements-andannouncements/reg-framework-virtual-asset-portfolios-managers-fund-distributors-trading-platform-operators.html

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