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GLOBAL CRYPTO REGULATION: COMPLIANCE AND ENFORCEMENT

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HOT TOPIC

GLOBAL CRYPTO REGULATION: COMPLIANCE AND ENFORCEMENT

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John Ahern is a partner in the financial markets and products group. With more than 30 years of experience in UK, European and Asian financial markets, he advises banks, multilateral trading facilities, broker-dealers, asset managers and investment advisers on regulatory challenges. He offers clients who are active in the transport, energy and infrastructure sectors deep knowledge of how regulators in different jurisdictions approach compliance and enforcement issues and helps them operate in compliance with financial regulations, while also maximising opportunities.

R&C: What do you consider to be among the most significant developments shaping the crypto landscape? How has the market fared over the last year or so?

Alvarez: Over the past few years, significant developments have emerged in the cryptocurrency landscape. Regulatory scrutiny has intensified, especially after high-profile collapses of major crypto companies, prompting discussions for clearer regulations worldwide. More businesses and financial institutions are integrating cryptocurrencies into their services, enhancing mainstream acceptance and usage. Innovations such as Layer 2 solutions and decentralised finance (DeFi) platforms have improved scalability and usability, making digital assets more attractive for everyday transactions. Institutional interest from hedge funds and traditional financial firms has remained strong, contributing to market stability. In 2023, the cryptocurrency market showed mixed performance following a downturn in 2022, but signs of recovery emerged by late 2023 and into 2024, driven by renewed interest from retail and institutional investors. Major cryptocurrencies have demonstrated resilience, indicating growth potential, although ongoing regulatory developments and market dynamics continue to influence investor sentiment and trading activity.

Kerrigan: Crypto exchange-traded funds (ETFs) have demonstrated there is demand for bitcoin as an asset class. Whether regulators like it or not, people want exposure within a traditional investment wrapper and the launches broke records for inflows to new ETFs.

Salmon: Arguably, the most significant development shaping the cryptoasset industry is regulation. Regimes such as the Markets in Crypto-Assets Regulation (MiCA) in the European Union (EU) have forced firms to adapt their processes to comply but also chart a more long-term future and allow investment into the industry, safe in the knowledge of regulatory clarity. Furthermore, it has also provided the basis for institutional investment and involvement in the industry as noted by greater institutional adoption, as well as the development of bitcoin futures ETFs to embed cryptoassets as a mainstream asset class. This latter point has perhaps shielded the industry from what have been quite difficult conditions, as high interest rates, high inflation and geopolitical events have stymied investment in the industry. However, over this period industry has also witnessed increased consolidation and ongoing innovation. For example, we have seen the building of more Layer 2 products to improve efficiencies as well as to support scaling.

Ahern: The crypto market appears to be here to stay for the foreseeable future. It is a highly topical area and seems to be demonstrating some growth over the last year. The cryptoassets market emerged from the foundations that had been laid 16 years earlier from cryptography research on using blockchain technology to validate data integrity over an open network. The eventual breakthrough in blockchain technology gave birth to bitcoin in 2009, ushering in a new era in digital finance. Bitcoin adoption and other factors propelled the digital assets market from approximately $5bn in market capitalisation to over $500bn between 2014 and 2016. Now the size is more than $1 trillion. The initial coin offering (ICO) boom, triggered by various smart contract applications and boutique token offerings across industries, pushed the market past the trillion-dollar threshold. The landscape outlook is interesting – the effect of the collapses in recent times has caused considerable concern, however.

R&C: To what extent have the high-profile collapses of crypto companies amplified calls to address crypto regulation?

Kerrigan: The history of crypto is shown in the bitcoin price chart. The number goes up then down but, so far, each new high is higher than the one before. In many ways, the last crash was caused by the failure of FTX, and this was different from previous crashes in two key respects. First, it was the first crash where retail investors were substantially affected. Second, it was the first time regulated exchanges had been affected. Naturally, regulatory scrutiny followed. The issue that the industry has been getting stuck on since then is that many regulators responded by trying to ban it rather than work out how to permit it, but you can no more ban crypto than you can ban the internet.

Salmon: High-profile failures in the cryptoasset space in recent years have sharpened regulators' focus and driven the adoption of new regulatory regimes. In particular, the interconnectedness of cryptoasset markets and susceptibility to contagion risk, high retail investor involvement, as well as the speculative nature of the value of certain types of cryptoassets, have put a limelight on the need for robust investor protection rules. Moreover, events leading to such collapses have informed the approach to developing regulatory requirements around the world. By way of example, the International Organization of Securities Commissions (IOSCO) 'Policy Recommendations' issued in 2023 references the events of 2022, and includes, among other things, requirements around ensuring the ability of commonly accepted and purportedly 'stable' assets such as stablecoins, to maintain their value under stress, the adequacy of reserve

or backing assets, as well as requirements around segregation of custodied assets and managing conflicts of interest.

Ahern: Prior to any of the high-profile collapses, regulators internationally have been looking at how to regulate and have been formulating regulation of the market. The area is relatively new, growing quickly and crypto business poses regulatory and financial stability threats that are different from those that arise in traditional asset markets. The EU's MiCA will apply from 30 December 2024. However, rules on asset-referenced tokens and e-money tokens under that regulation have applied since 30 June 2024. In the UK, the Financial Conduct Authority (FCA) continues to consult with stakeholders and market participants to formulate the regime for the regulation of cryptoassets markets. It is aiming to create a regime that puts in place strong systems and controls that enable fair, orderly, transparent and efficient trading. For trading platforms and intermediaries, the FCA is looking closely at topics like location policy, operational resilience requirements, conflicts of interest and matching. Global regulators are contributing to the implementation of international crypto regulatory standards through the IOSCO. In the UK, the FCA is already working with industry and the Treasury to help shape an industry-led market-abuse information-sharing platform, as a component of the regulatory regime.

Alvarez: The collapse of a large cryptocurrency exchange revealed serious issues like mismanagement and lack of transparency. Additionally, the failure of a protocol and platform underscored the risks associated with algorithmic stablecoins. The bankruptcies of cryptocurrency lending platforms further highlighted problematic lending practices, emphasising the need for customer fund protection. In response to these developments, regulatory bodies around the world have begun to take significant action. In the US, the Securities and Exchange Commission (SEC) has ramped up scrutiny of unregistered securities offerings, leading to Wells notices and subsequent investigations. Meanwhile, the EU has advanced its MiCA regulation, which aims to establish a comprehensive regulatory framework for the sector. Additionally, countries such as South Korea and Japan have revised their regulations to strengthen customer protection. These failures have not only shaped regulatory responses but have also intensified advocacy for increased oversight and transparency in the cryptocurrency market.

R&C: How would you characterise the evolution of regulations governing the crypto market? What are the key

regulatory challenges posed by digital assets?

Salmon: The evolution of regulatory treatment has been sharp. What began with looking at the industry solely through the lens of anti-money laundering (AML) and counter-terrorist financing (CTF) risk in the early days, the industry has developed and integrated into mainstream finance resulting in the broadening of this lens to include financial stability and monetary control. This has brought challenges with existing laws not being fit for purpose for the industry. The prime example of this is DeFi. Where existing financial services legislation is based around finding an accountable intermediary, challenges arise where no such intermediary can be easily identified, and regulators may not necessarily hold the right entities or persons accountable. The question of jurisdiction also comes into focus. With the industry being cross-border in nature, firms are operating across multiple jurisdictions and often without a physical presence. This presents a number of challenges including establishing the relevant competent authority and guarding against regulatory arbitrage.

Alvarez: Regulations governing crypto markets have evolved gradually, recognising the need for oversight amid rapid growth. Initially, many regulators adopted a wait-and-see approach, however incidents of fraud prompted a shift toward proactive compliance. Key regulatory challenges include unclear definitions of terms like ‘cryptocurrency’ and ‘stablecoin’, which hinder consistent regulations across regions. Rapid advancements in DeFi and non-fungible tokens (NFTs) often outpace existing regulations, leaving oversight gaps. Consumer protection is critical, as many investors are unaware of the risks, making them susceptible to fraud. The decentralised and often anonymous nature of transactions can facilitate cyber crime, complicating security enforcement. Lastly, effective regulation hinges on international cooperation, however varying priorities and legal frameworks can impede collaborative efforts to tackle these challenges.

“The development of regulations governing this unique market has been very mindful of the need to promote innovation on the one hand and ensure financial stability on the other.”

John Ahern,
Watson Farley & Williams LLP

Ahern: The development of regulations governing this unique market has been very mindful of the need to promote innovation on the one hand and ensure financial stability on the other. Regulatory challenges raised by this market include legal and regulatory uncertainty. The legal analysis of the nature of a digital asset may be different, depending on the relevant jurisdiction. Accordingly, conflicts of laws and similar issues may make legal proceedings difficult. For example, how does one characterise a cryptoasset in legal terms? When the markets moved to dematerialising securities back in the 1990s, questions as to what a book entry means legally arose. They were resolved and the helpful English law concept of a 'chose in action' was flexible enough to cover book entry securities, as interests in those assets could be discerned. Furthermore, in the absence of harmonised regulation of this asset class, regulatory arbitrage opportunities will arise, which will be a challenge for regulators. Another challenge is financial crime. All of the recent collapses of crypto platforms have involved fraud. While the law enforcement authorities have been able to take appropriate action in some jurisdictions, notably the US, this has not been the case in relation to some players who have simply disappeared. A good example is the case of Dr Ruja Ignatova, chief executive of the collapsed and fraudulent scheme OneCoin – the so-called missing 'Crypto Queen'. Financial stability is yet another challenge. It goes without saying that large volumes of trading in markets can be a threat to market stability, especially when there is a significant collapse. How regulators will deal with that threat will be a delicate balance between innovation, which is the darling of many markets currently, and stability.

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> *Hogan Lovells International LLP*

Kerrigan: Given the results of the US presidential election, the US policy changes in 2025 will likely be transformational. The US is the home of crypto – it has more builders, more ideas, more money and more optimism than anywhere else. These are the ingredients for rapid developments. The US rarely gives the rest of the world a head start in a

new market in which it itself excels. It has done so, however, in crypto over the last four years – but no longer. It is hard to say what US crypto regulation will look like at the end of 2025 as they try to figure out how to balance facilitating the market without giving innovators so much rope that they hang themselves and lose customer money. There are large and respected crypto firms that are ready to be regulated in a sensible way. Starting with them will move the ball forward for everyone.

R&C: What approaches are regulators taking toward enforcement of crypto regulations? Are such efforts intensifying?

Ahern: Currently, any regulatory rules on crypto are either newly introduced or nascent in their development in many jurisdictions. To the extent that any cryptoassets are of a type currently regulated, regulators are taking a robust approach to enforcement. In the UK, for example, the FCA took enforcement action for the first time in July 2024 against a firm enabling cryptoasset trading. The case involved CB Payments Limited, which was fined £3,503,546 by the FCA for repeatedly breaching a requirement that prevented the firm from offering services to high-risk customers. That company is part of the Coinbase group, and while it did not undertake cryptoasset transactions for customers itself, it acted as a gateway for customers to trade cryptoassets via other entities within the Coinbase group. The company was not registered to undertake cryptoasset activities in the UK. While the case related primarily to money laundering concerns, it is noteworthy that in the context of crypto, the regulator used tools available under other relevant branches of regulation to proceed in order to address the risks. It is to be expected that, as regulatory rules become embedded, regulators will use the full armoury of their enforcement tools to deal with threats from firms' behaviours in the crypto markets.

Kerrigan: Regulatory outlook and enforcement differs around the world. Regulators are still focused on the same headlines that apply to everything, including crypto – namely, stopping financial crime, stopping consumer harm and avoiding systemic risk. Regulations that directly apply to crypto are still so new that we are yet to see which cases regulators take and how they do so in practice. In any event, we do not need crypto regulations for most of the egregious issues: scammers and hackers commit fraud and theft.

Alvarez: Regulatory bodies, particularly the US SEC, have intensified enforcement activities, targeting areas such as ICOs, unregistered trading platforms and securities fraud. This heightened scrutiny has resulted in numerous investigations of

prominent virtual asset service providers (VASPs) and individuals accused of violating securities laws. A key strategy involves classifying certain cryptocurrencies as securities, subjecting them to traditional financial regulatory requirements, which has sparked debate over definitions and the need for clearer regulations. Additionally, international coordination is becoming essential, due to the global nature of cryptocurrencies, with initiatives like the Financial Action Task Force (FATF) guidelines seeking to standardise regulations and combat money laundering and terrorist financing in the digital asset space. Overall, these trends indicate an increase in regulatory efforts focused on enhancing market integrity, protecting consumers and promoting transparency.

Salmon: Regulators are taking a range of approaches toward enforcement, whether that is direct action against firms and imposing fines, putting in place licensing requirements or working with private firms to use blockchain analytics to identify bad actors. What is clear is that as the industry grows, so too does scrutiny of it. From a regulator's perspective, this has resulted in hiring new teams and boosting competencies to be able to address this. One such example has been the UK financial promotions regime. The FCA has stood up a specific team for this and has taken a proactive approach to identifying and taking down unauthorised promotions, including by working with third parties such as tech companies to block websites, apps and social media accounts.

R&C: Given the rapid evolution of technology and law, what advice would you offer to companies on establishing internal processes and controls to manage risk and compliance challenges arising in connection with crypto assets?

Kerrigan: Among the fairest criticisms levelled at the crypto industry is that it still suffers from hacks and scams.

Firms should spend whatever it takes to be secure. Processes and controls are a footnote to that.

Alvarez: Companies should implement key strategies to establish effective internal processes and controls for managing risk and compliance challenges. First, they need to develop a comprehensive compliance framework that aligns with existing financial laws and the evolving digital asset regulations. This framework should include robust policies for know your customer (KYC), AML, sanctions compliance and transaction monitoring to meet legal requirements. Regular risk assessments are essential for identifying operational vulnerabilities, while strong internal controls mitigate risks related to fraud, misconduct and data security. Additionally, staying informed about regulatory developments, providing ongoing staff training and periodically refining compliance systems are critical. Engaging with legal and compliance professionals in digital assets can offer insights into navigating complex regulations and identifying compliance risks. Leveraging technology solutions, such as blockchain analytics tools and case management systems, can enhance monitoring capabilities. Finally, a clear whistleblower policy promotes transparency and encourages the reporting of suspicious activities, strengthening the culture of compliance.

Salmon: For companies that have yet to establish relevant internal processes and controls, the key is to start now. This applies even where entities may fall outside the scope of existing regulation. For example, depending on the jurisdictions from which they operate or to which they provide services, or the specific cryptoasset activity being performed, the direction of travel on a global scale suggests that some regulation of cryptoasset market participants is likely to be inevitable. This is particularly the case where retail investor assets are involved, and in high-risk areas such as AML and CTF. Additionally, companies should take heed of international standards and best practices as indicated by regulatory authorities or standard-setting bodies. Generally speaking, in a sector where many market participants may only be at the beginning of their compliance journeys, benchmarking against the practices of industry peers would not necessarily discharge an entities’ obligations under relevant regulation.

Ahern: The areas of technology and law are very different disciplines – the former at the cutting edge of modern innovation and the latter always in a position of catching up in order to fit the technological developments into the legal framework and establish a legal construct. There needs to be a highly cooperative collaboration between tech experts and the compliance and legal functions to

development coherent risk management processes and controls around cryptoasset business. Companies need to focus on financial crime, consumer protection, legal account documentation. and terms and conditions of business, among others. Furthermore, firms should be closely watching the development of regulatory requirements in this area and ensure they stay up to date, as it is a fast-moving field.

R&C: In what ways does the disparate network of crypto-related regulation around the world raise fundamental questions about what rules apply, to whom, as well as how to enforce them?

Alvarez: The global landscape of crypto-related regulations presents significant differences in how countries classify cryptocurrencies. For instance, in the US, the SEC considers certain cryptocurrencies as securities, imposing traditional compliance requirements. In contrast, Switzerland views cryptocurrencies as assets, allowing them to be governed under property laws. Companies often exploit these regulatory discrepancies to gain competitive advantages. For instance, some cryptocurrency exchanges operate in jurisdictions with less stringent regulations, such as Seychelles or Malta, enabling them to evade rigorous compliance measures required in more regulated markets like the US or Europe. The decentralised nature of cryptocurrencies further complicates enforcement. A fraudulent ICO launched in one country can attract global investors, making it challenging for regulators to act against bad actors. Enforcement becomes difficult when regulators lack jurisdiction over entities located outside their borders, underscoring the need for international cooperation and standardised frameworks, such as MiCA, to effectively protect investors.

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>
> *Charles Kerrigan, CMS UK*

Salmon: A key question which frequently arises is on the territorial scope of crypto-related rules, which tends to vary by jurisdiction. Some providers may find themselves falling foul of regulatory

regimes despite not operating within the relevant territory. The UK's regime on financial promotions, for example, has cross-territorial effect – entities that do not actively target the UK, but nevertheless do not restrict access to services and communications by UK users, may still find themselves in breach of the regime. Jurisdictional divergences also exist in the context of enforcement, which leads to further regulatory uncertainty and difficulties for entities providing services online, on a multijurisdictional basis. For instance, while the EU's MiCA regulation seeks to establish a single rulebook across the EU, in reality, national authorities may interpret the rules differently, or be at varying levels of readiness to enforce the rules under MiCA, although such divergence will likely diminish over time.

Kerrigan: Crypto is money on the internet combined with innovation in secure messaging in business models – as truly decentralised business models such as decentralised autonomous organisations cannot be easily regulated as a practical matter – and in identity. Crypto people are not likely to stop when they have remade money; they intend to remake the internet as well. The cliché that regulation trails innovation spoke to a problem that existed even when business model innovation was incremental. Crypto and artificial intelligence are compounding technologies and there are no easy answers to the challenges of regulatory policy or practice. Consumer education and support should be a shared goal and something all good actors can work together on.

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Javier Alvarez, BDO

R&C: How do you foresee regulation and enforcement in this area developing? What trends are likely to shape the crypto market in the years ahead?

Salmon: As seen through the work of the FATF, IOSCO and the Organisation for Economic Co-operation and Development, there is the development of global standards and approaches

to ensure that the regulatory net is cast wide and consistently. We have seen this already with a global approach toward money laundering rules, such as the Travel Rule implementation. We are also starting to see more countries put in place regulatory frameworks for digital assets in line with the IOSCO guidelines. The next step will be a shift toward better global coordination and addressing issues such as DeFi and staking. Looking forward, sustainability considerations will be increasingly important. While MiCA has put in place sustainability reporting requirements, as more jurisdictions develop their regulatory frameworks, this matter will no doubt come into greater focus and firms will have to consider what measures they need to put in place.

Kerrigan: More things will go wrong, the price will go down as well as up, and there will be more scandals and systemic issues each time this happens. The point about crypto speedrunning the 5000-year history of money and finance is illustrative because it is true. The only thing we can say for sure about developments in crypto is that no one can see far ahead. Legitimation in the US comes with risks but would change the way the world sees crypto – hopefully for the good.

Ahern: This is still a very new area in the context of the global financial markets. Global regulatory organisations and national regulators seem committed to focusing keenly on how to regulate it. The unique threats of this innovative market – blockchain, anonymity, the global nature of the market in crypto, fraud, market abuse and other issues – make for significant challenges to regulatory and law enforcement authorities all over the world. Ultimately, however, regulation gets to grip with new and innovative markets and a compendium of coherent regulatory requirements and enforcement processes will develop over time. This has always been the case.

Alvarez: Under the new US administration, regulators may shift their approach and move away from regulation by enforcement, particularly at the SEC. Investigations may focus on potential market manipulation by crypto market makers, and issues related to DeFi protocols, NFTs, algorithmic stablecoins, staked assets and cyber security incidents. This reduced regulatory pressure may encourage investors to explore start-up opportunities, fostering growth in the crypto landscape. As fears of enforcement actions subside, regulators will prioritise identifying actual fraud and enhancing asset security, particularly regarding smart contract vulnerabilities. Companies and individuals will have more influence on shaping regulations or supporting candidates who advocate for their interest. Globally, we anticipate the emergence of comprehensive, harmonised

regulatory frameworks through international cooperation to establish consistent guidelines that address cross-border activities. The MiCA regulation exemplifies this effort, aiming to standardise cryptocurrency regulation across EU member states. Alongside this, increasing institutional adoption of practical compliance efforts with AML and KYC regulations will continue, leading to enhanced oversight of VASPs. R&C