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Legal genesis of virtual asset circulation in Ukraine and Worldwide: Risks and concerns

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Abstract

The peculiarities of the creation and circulation of virtual assets in the context of their decentralised nature and limited legal regulation are of not only scientific but also practical interest to both states and other entities that have the ability and desire to use them in their daily lives. The formation of full-fledged global and national virtual asset markets is an extremely important step in the context of taking advantage of digitalisation, but the creation of such markets must be transparent, which cannot be ensured without proper legal regulation. The research aims to study the legal regulation and reveal the content of virtual assets as a phenomenon and an instrument from the standpoint of their functional characteristics and the risks that may arise in the course of their circulation, as well as the abuse in this area and the international experience of combating it. Comparative legal, analytical, formal logical and synthetic methods of scientific cognition were used in the study to analyse the legislation of the European Union and other countries and the practice of specialised regulatory authorities of the United Kingdom and the United States of America concerning their impact on the circulation of virtual assets. The author draws parallels with the attempts to conduct rule-making processes in Ukraine and synchronises them with the rule-making work at the international level to create a new conceptual and regulatory framework and attempt to regulate the status of virtual assets. Several proposals have been made, the implementation of which will create the preconditions for the development, approval, and implementation of proper legal regulation of the circulation of virtual assets in Ukraine. Their implementation will enable the interstate exchange of information to prevent abuses in the field of activity under study, in particular, money laundering. The results of the study can be used to formulate public policy and improve legislation in the field of virtual assets circulation

Keywords:

digitalisation; blockchain; cryptocurrency; token; decentralised finance; Markets in Crypto assets; Central bank digital currency

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Introduction

The economy needs clear legal instruments that should unambiguously and consistently regulate the processes in the systems that make up its components. Digital technologies are an integral part of any modern economy due to their high degree of productivity and technological capabilities. A distinctive feature of the Ukrainian economy is the introduction of digital technologies into everyday life, both to speed up management decision-making and to implement them to achieve the purpose of their adoption. Virtual assets built on blockchain technology can completely change financial systems, as these systems do not meet the requirements of the modern market or the elements that are part of it in their usual form. The issues of legal regulation of virtual assets as a phenomenon, solving the problem of their uncontrolled existence and peculiarities of circulation are not yet sufficiently covered by both foreign and Ukrainian scholars, which accordingly necessitates our scientific search and further research in this area.

The issue of legal regulation of virtual assets in the United States is addressed by M. Inshyn *et al.* (2018), exploring the possibilities of legal entities and individuals to use these assets as legal means of payment. However, insufficient attention was paid to the need to introduce such regulation at the federal level, as the authors focused only on the legislative initiatives of individual states. To increase the empirical potential of the study, the author will analyse the practice of the US Securities and Exchange Commission in dealing with cryptocurrency exchanges and the decisions it has made.

The content of the information that should record the fact of the relevant crypto transfer was analysed by I. Ilijevski *et al.* (2023), noting the need to include information about the parties to the transfer, although the ways of its implementation are not fully considered. The researcher focuses on disclosing the content of the activities of other bodies that may be involved in the process of controlling the circulation of such a virtual asset as cryptocurrency, and the activities of crypto exchanges, in particular, in Ukraine and other countries, and which would prevent abuse in this area. At the same time, money laundering, which is possible through the use of virtual assets, was not sufficiently addressed. This issue is raised by T.V. Pavlenko & M.M. Duchenko (2019). The authors focus on the high level of risk in the use of cryptocurrencies, revealing the content of the activities of the financial regulators of the European Union and the warnings they have made in this regard. It is worth noting that this issue requires more scientific

understanding and the use of the existing practice of the specified regulators, which is only increasing every day due to the growing capacity of the virtual asset market. A. Wadsworth (2018), studying cryptocurrency, points out the possibility of its expression in various forms, but does not provide a list of them and does not disclose their content, focusing only on its relation to the technology of payment infrastructure and achievements of crypto technologies.

To summarise, it is worth noting that foreign and Ukrainian researchers have not come up with an unambiguous answer to the question of what cryptocurrency is and how it differs from other types of virtual assets, both in terms of content and the specifics of their acquisition, accumulation, or circulation. At the same time, the issue of abuse in the handling of virtual assets has hardly been studied at all, and the existing abuses are not without subjective perception when assessing actions related to combating money laundering. This uncertainty poses significant current and potential threats, not only to the financial and monetary system of Ukraine but also to any other state, making it possible for third-party financial influence to be exerted on them beyond any administrative or criminal law control.

Therefore, the research aims to achieve terminological certainty and establish distinct features of virtual assets as a phenomenon that can harm society. Due to insufficient legal regulation, particular attention is devoted to describing the risks and threats arising from the use of various legal mechanisms in the course of committing the relevant abuses, so that these abuses become apparent and are prevented in the future.

Materials and Methods

A range of scientific methods were used in the research. The comparative legal method was used to analyse the legislation and analytical documents of the European Union, the United Kingdom, the United States of America, and Australia, comparing them with Ukrainian initiatives. The study used the provisions of the Markets in Crypto-assets Regulation¹, the UK National Money Laundering and Terrorist Financing Risk Assessment Report (HM Treasury, 2020), and the US Securities and Exchange Commission's practice of interaction with cryptocurrency exchanges (Charges Against Binance)². The analysis of these documents and the experience gained formed the basis for the development of proposals for regulating the circulation of virtual assets in Ukraine. The development of the Regulation on the

¹ Position of the European Parliament EP-PE_TC1-COD(2020)0265 "Adopted at first reading on 20 April 2023 with a view to the adoption of Regulation (EU) 2023/... of the European Parliament and of the Council on markets in crypto-assets, and amending Regulations (EU) No. 1093/2010 and (EU) No. 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937". (2023, April). Retrieved from https://www.europarl.europa.eu/doceo/document/TC1-COD-2020-0265_EN.pdf.

² Civil Action No. 1:23-cv-01599 "SEC Complaint against Defendants Binance Holdings Limited". (2023, May). Retrieved from <https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-101.pdf>.

Regulation of Virtual Assets made it possible to propose the division of virtual assets into forms depending on their content and content, highlighting their general, common features and distinctive characteristics. The Report on the National Money Laundering and Terrorist Financing Risk Assessment in the United Kingdom made it possible to use the experience of specialised bodies in implementing a systematic analysis of the processes related to the need to take measures to control the shadow capital flow. The practice of the US Securities and Exchange Commission's interaction with cryptocurrency exchanges, a review of response tools and attempts to influence the activities of specific cryptocurrency exchanges have pointed to the need to unify international legal regulation of their activities.

The application of comparative legal and analytical methods was used to utilise the best practices of banking and financial regulators in the United States, such as the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC)¹, the work of the Financial Action Task Force on Money Laundering (FATF) (FATF, 2015) and to provide the author's recommendations on approaches to the tracing and seizure of virtual assets. These methods were used during the development of the European Parliament and Council² Directive on the Prevention of the Use of the Financial System for Money Laundering or the Financing of Terrorism to determine the limits of legal liability when establishing existing permits or restrictions on the exchange of real assets for virtual ones.

The use of formal logical method was used to describe the mechanisms of abuse of such existing tools for exchanging fiat currency for virtual tokens as 2P2 (from the English peer-to-peer, person-to-person - from person to person, from equal to equal) and unregulated crypto exchanges (operating based on regulated currency exchanges). New forms of virtual assets – NFTs and marketplaces as platforms for their purchase/sale – are also highlighted. This method was used to highlight the process of illegal use of virtual assets to transfer assets from the real economy to the virtual sphere and to further move significant amounts of financial resources without state control and supervision, with the corresponding risks for the state. The synthesis method was used to develop and propose the use of the concept of “virtual asset mixing” to describe the process of legalisation of financial resources from uncertain sources of origin and their uncontrolled transfer to another legal jurisdiction.

Results and Discussion

As a derivative of blockchain technology, virtual assets first began to spread in the information space only in 2008, when the study “Bitcoin A Peer-to-Peer Electronic Cash System” was published (Krishnan *et al.*, 2023). For the proper formation of the definition of term “cryptocurrency”, the concept of “currency” and consider the world practice should be considered. Thus, in its standard terms and conditions, the European Bank for Reconstruction and Development defines “currency” as the legal tender of a country, which is a legal tender for the payment of public and private debts in that country³ Although financial regulators in EU countries have warned citizens that cryptocurrencies are very risky assets due to their high volatility and speculative prices, the number of participants in this market is only growing every year (Pavlenko & Duchenko, 2019).

The legislation of most foreign countries in these matters is guided by their achievements and peculiarities of the perception of virtual assets. Relevant regulation of the issue under study, in one form or another, already exists in the United States, the United Kingdom, Australia, New Zealand, Germany, Austria and France. It is worth emphasising that this regulation is fragmented and will require the development of supranational rules in the future, as the circulation of virtual assets and the peculiarities of ensuring the technical component of this issue makes it possible to disregard the borders of the territories within which modern states exist. Virtual assets are usually decentralised and are not controlled by states or their financial or securities authorities. At the same time, attempts to introduce control or regulation tools for the circulation of virtual assets can be seen in the activities of the United States Securities and Exchange Commission (SEC), when, on its initiative, the activities of some crypto exchanges become the subject of court proceedings as part of relevant investigations, including Binance⁴. This investigation is being conducted in light of alleged violations of investor protection and the circulation of virtual assets treated as securities, as no other legal regulation has been adopted to which the SEC could appeal. Thus, specialised authorities are already beginning to use their control and supervisory functions in their interaction with the virtual asset market.

Evolution of the terminological uncertainty of the concept of “cryptocurrency”. Given a certain inaccuracy in the content of the concepts of “cryptocurrency” and “virtual asset”, the author suggests that when

¹ Report of Investigation according to Section 21(a) of the Securities Exchange Act of 1934: The DAO No. 81207. (2017, July). Retrieved from <https://www.sec.gov/files/litigation/investreport/34-81207.pdf>.

² Directive (EU) 2018/843 “Of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU”. (2018, May). Retrieved from <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32018L0843>.

³ Position No. 985_017 “Standard terms and conditions of the European Bank for Reconstruction and Development”. (2006, May). Retrieved from https://zakon.rada.gov.ua/laws/show/985_017#Text.

⁴ Civil Action No. 1:23-cv-01599 “SEC Complaint against Defendants Binance Holdings Limited”. Retrieved from <https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-101.pdf>.

defining their content, the following aspects should be considered – cryptocurrency is not a currency in its broadest sense, it should be considered the most convenient type of virtual asset among those that already exist. Given the potential protection and support of centralised states, it is cryptocurrencies that can, based on the existing supply and demand, and above all, investor confidence, be a means of accumulating and transferring the relevant value. Ultimately, cryptocurrencies can become a type of currency only after they are introduced and recognised by a particular state as a CBDC (Central bank digital currency). In general terms, cryptocurrency is a type of virtual asset that is intangible and has other forms of manifestation besides cryptocurrency, but cryptocurrency, due to its universal nature, is the most convenient way to transfer value.

The current absence of regulatory definitions of what cryptocurrency is indicates the need for proper legal regulation of this issue. The establishment of such definitions and their regulatory consolidation should provide all interested parties with the opportunity to use such assets and do so in a way that does not threaten the traditional financial and monetary system of any state. Ignoring the above will make it impossible for any national economy, especially Ukraine's, to integrate into the global economy, where the share of virtual assets in turnover and capitalisation is growing rapidly. So far, virtual assets are not replacing traditional means of payment or accumulation of value, but in the near future, this will begin to happen. It is also worth mentioning other forms in which virtual assets and capital transfer instruments are reflected. These, in the author's opinion, include tokens of crypto projects (Ethereum, Tether), crypto exchanges (Cake), proprietary tokens of crypto networks (Aptos, Arbitrum, Optimism), etc., and non-fungible tokens (NFTs) or their collections, each of which has its capitalisation, supply and demand. NFTs are not a currency, as each of them is unique and inimitable, but similar to any other form of virtual asset (image, sound recording, etc.), they can be a means of accepting and accumulating a certain value, storing, and transferring it anywhere in the world, including through the purchase and sale, or even unilaterally destroying it. Each of the above forms of virtual assets is technically similar to each other, but they are completely different in their functional purpose as instruments of both capital consolidation and its movement between owners.

So far, despite the existing attempts to regulate only the issuance and circulation of crypto project tokens and cryptocurrencies¹, the circulation of NFTs remains outside the regulators' attention, although their capitalisation and circulation are becoming increasingly significant and are already used as a tool for capital

movement. It is the problem of crypto project tokens and the possibility of their instrumental use that has led to the emergence of proposals for the introduction of CBDC. In particular, the XRP (Ripple) token is currently used by financial institutions for settlements, currency exchange, and cross-border money transfers (Chakraborty *et al.*, 2023). However, the implementation of CBDC requires a healthy balance, and for this purpose, Central Banks and special authorised bodies will have to create new and additional infrastructure, primarily technical, which should allow the system to be managed without violating confidentiality and ensuring the protection of access to relevant information (Hrytsai, 2022). This is confirmed by the practice of implementing CBDC in Nigeria in 2021 (Lukianchuk, 2022). At the same time, even without the adoption of relevant regulations that would regulate the status of a virtual asset as a cryptocurrency, the state of California allowed the use of cryptocurrencies in 2014, allowing corporations, associations, or individuals to use them along with legal tender (Inshyn *et al.*, 2018). The author believes that CBDC, in the case of its generalised perception, will not contain any signs of decentralisation at all, since the issue of its circulation is synchronised with ensuring the financial security of any state, which the respective states will both protect and support. However, this should be preceded by the development and implementation of appropriate legal regulation.

So far, different countries have different perceptions of virtual assets and there is no single view on their control. For example, in November 2017, New Zealand, represented by the Financial Conduct Authority, already equated transactions with digital currencies with transactions with securities, and Australia passed a law that began to regulate the activities of cryptocurrency exchanges and obliged them to register with the Australian Transaction Analysis and Reporting Centre. The legislative regulation of cryptocurrencies is a pressing issue that must be addressed both at the level of each state and at the international level. With the growing popularity of cryptocurrencies, countries around the world will be in a hurry to build regulatory frameworks (Lukianchuk, 2021). Some EU countries (Germany, Austria, France) already have a regulatory framework for the circulation of virtual assets, including cryptocurrencies, and the experience of these countries can serve as a guide for current and future legislative developments (Nekit, 2021).

The legal uncertainty of the status and lack of legal regulation of the circulation of virtual assets in the United States led to the adoption of an Investigative Report under Section 21(a) of the Securities Exchange Act of 1934 in July 2017: DAO. This Report² outlined

¹ Report of Investigation Under Section 21(a) of the Securities Exchange Act of 1934: The DAO No. 81207. (2017, July). Retrieved from <https://www.sec.gov/files/litigation/investreport/34-81207.pdf>.

² Ibidem, 2017.

the possibility and conditions for treating virtual assets as securities if offered to US residents, or vice versa, as commodities if such assets are used as underlying in derivative financial instruments. Given the above and based on the content of the Report, virtual assets may be subject to regulation and control measures by either the SEC or the CFTC.

Risks and concerns regarding the use of virtual asset circulation opportunities. The instrumental capacity of the virtual asset circulation system creates opportunities for tax evasion, non-declaration of assets, terrorist financing, money laundering, and circumvention of the sanctions regime of international settlements, which makes it very attractive to criminals and the shadow economy (Dupuis *et al.* 2021). The use of these instrumental capabilities in the process of circulation of virtual assets by criminals requires the latter to formulate a strategy for combining large amounts of cash with the possibility of converting it into a virtual asset and moving it to another territorial jurisdiction. This process is also associated with the need to ensure a high degree of financial confidentiality, which can be provided by the relevant payment technology and its inherent transaction processing methods. A centralised transaction mechanism is characterised by its accessibility to both counterparties and a financial intermediary (controlled by the state through rules and restrictions), which is responsible for its execution and results in its recording. In contrast, cash-decentralised payments involve the transfer of cash from hand to hand and the process is not subject to any record, except by the parties themselves (Hendrickson & Luther, 2019).

As law enforcement agencies gain more and more experience in the field of virtual assets, facts of their use in committing financial crimes are becoming more frequent. Among them, money laundering occupies a prominent place (Dyntu & Dykyi, 2018). The author believes that the only guideline for combating abuse is the practices established by the FATF, which creates the need for their implementation in national legislation. The irreversibility of transactions means that they cannot be cancelled or appealed, which makes it undoubtedly possible to establish a causal link between an action and its consequences. This is especially important in the context of linking the relevant action to a specific person, even though this area is very convenient for criminals (Grebenyuk & Chernyak, 2018).

The irreversibility of blockchain transactions is also a sign of the risk of asset loss or seizure in the event of both an error in the choice of the recipient and the impossibility of blocking such a transaction due to its rapid execution. The absence of procedures for legally restricting the circulation of virtual assets demonstrates

the ineffectiveness of any attempts by any specialised authorities to block such transactions. The only thing they can do is to impose restrictions on the future circulation of a particular virtual asset, and only if it is determined by the rules agreed to by the relevant operators of such circulation (crypto exchanges, marketplaces, or other platforms) (Akartuna *et al.*, 2022).

The European Parliament and Council (EU) Directive on the Prevention of the Use of the Financial System for Money Laundering or the Financing of Terrorism¹ states that banking secrecy is important, as the unregulated circulation of virtual assets is used by criminals to move financial resources between different jurisdictions incognito. They do this by using various forms of these assets with the subsequent withdrawal of resources from virtual to real circulation.

The decentralised nature of such assets makes their circulation very convenient but uncontrolled and potentially dangerous. In practice, it is quite easy for any card account holder to commit such abuse. It is enough to register on a crypto exchange and use the aforementioned 2P2 tool. J. Wu *et al.* (2021) note that 2P2 is a method of peer-to-peer payment transfer without any centralised supervision, which makes it a tool for exchanging fiat currency (held on a card account) for virtual tokens without government control. The only restrictions on this process will be the limits set by banks on the movement of certain card accounts held by the parties involved in the exchange, or the rules of a particular exchange. But even here, there is a way out, when such accounts are conditionally leased, and although this contradicts the rules of banks, it cannot be controlled by them. This technology allows direct peer-to-peer transactions without intermediaries (Albrecht *et al.*, 2019). It is blockchain technology and 2P2 payments through their use by crypto exchanges/crypto exchanges that have made it possible to transfer cash into virtual assets and then transfer them anywhere uncontrollably. Significant volumes cannot be exchanged using 2P2, but in the case of an organised group with centralised process management, this is acceptable from an organisational point of view. Another tool for converting fiat currency into virtual assets is unregulated crypto exchanges (operating based on regulated currency exchanges), whose activities are still outside the scope of any legal regulation and require further study.

The above possibilities can be used to define a new legal and economic phenomenon – the “mixing of virtual assets”, which can be seen as disguising money from the real sector of the economy as cryptocurrency tokens or NFTs. Mixing with other similar resources/assets is usually done for laundering and disguising them as a legal asset so that in the future it is impossible to

¹ Directive (EU) 2018/843 “Of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU”. (2018, May). Retrieved from <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32018L0843>.

separate them from the total volume, and as a result, complicate the possible criminal legal qualification.

The analysis of these abuses necessitates compliance with the tools of the Financial Action Task Force on Money Laundering (FATF), which has developed the Guidance on the application of the risk-based approach (FATF, 2015). Virtual currencies, according to which decentralised virtual assets (so-called cryptocurrencies) are distributed, mathematically based, open-source assets that lack central administrators, control, or supervision.

Ways to counteract abuses in the circulation of virtual assets. To combat money laundering, states, through specialised authorities, should be able to monitor the use of such virtual assets, including through digital tracing. Such monitoring and “digital tracing” should ensure a balanced approach without hindering technological progress. At the same time, caution, and prudence in the implementation of prohibitions and restrictions on the circulation of virtual assets should ensure progressive movement towards the introduction of new business innovations. Excessive overregulation may become an obstacle that will force virtual assets to stay outside the scope of legal regulation and be used solely as a tool for shadow redistribution of financial resources. Consistent steps should be taken to develop and implement such legal regulation of the circulation of virtual assets, which is expected to create the preconditions for the establishment of a unified international legal framework that would enable the international community to interact with each other in these matters. This thesis is confirmed by a study of the impact of the degree of regulation of the circulation of virtual assets on the economy by M.M. Duchenko & T.V. Pavlenko (2018). Scientists believe that restrictions and overregulation alone will hamper market relations. An effective symbiosis of permits and restrictions is justified, which will protect both market participants and reduce the likelihood of criminal influence on it while creating the preconditions for effective taxation of the process of circulation of virtual assets and bringing them out of the shadows.

The first attempts to consider the risks associated with the circulation of virtual assets in Ukraine were made in 2016 at the level of the State Financial Monitoring Service of Ukraine. The Service’s experts analysed and published the National Risk Assessment Report on Preventing and Combating Money Laundering and Terrorist Financing (HM Treasury, 2020). It was developed following international standards, the content of which influenced the subsequent adoption of the Law of Ukraine “On Prevention and Counteraction to Legalisation (Laundering) of Proceeds of Crime, Terrorist Financing and Financing of the Proliferation of Weapons

of Mass Destruction”¹, which includes both electronic money and cryptocurrencies among the tools used by cybercriminals to launder money. These warnings were also reflected in the National Money Laundering and Terrorist Financing Risk Assessment (HM Treasury, 2020), which was sent to the British Parliament by the UK regulatory authorities. This was done because the scale and complexity of the UK financial services sector continue to make it attractive to criminals and corrupt elites seeking to launder criminal proceeds amongst the vast amounts of legitimate business.

The newly discovered opportunities for digital value transfers using blockchain technology have led to greater attention from the Ukrainian banking regulator, the National Bank of Ukraine, where in 2017 a meeting of the Supreme Expert Council of the NBU Council was held to raise the issue of insufficient attention paid to the circulation of virtual assets by government agencies that are supposed to control and regulate financial markets. The meeting resulted in the adoption of recommendations to prevent the formation of risks of reducing confidence in the hryvnia, which is the only legal tender in Ukraine, and creating preconditions for the use of virtual assets to support criminal transactions within the shadow economy, and thus reduce tax revenues (Novytsky & Fitsa, 2021).

The evolution of science and technology, the combination of their potential with the will of the professional environment in Ukraine and international experience have become the primary reasons for legislative regulation of the existence and circulation of virtual assets in Ukraine. The collaboration resulted in the adoption of the draft law “On Virtual Assets”² on 17.02.2022, which was expected to provide basic regulation of the said area of activity. The legislative initiatives of Ukrainian parliamentarians fully reflected the reaction to the emergence of a completely new sphere of social and economic relations, demonstrating an evolutionary search for legal answers to the question of the need for their regulation. However, it is not yet possible to speak of their successful nature and real implementation due to the delay in the entry into force of the already adopted Law. It provides for an important role for the National Securities and Stock Market Commission and the National Bank of Ukraine. This indicates an understanding of the peculiarities of the circulation of virtual assets and the involvement of these institutions in the issues under study. The adoption of the draft law indicates not only trends but also real steps towards the legitimisation of virtual assets in Ukraine (Kaznacheeva & Dorosh, 2020).

The updated draft law or any other new legislation in this area should be expected to create conditions for the legalisation of crypto exchanges, crypto exchanges,

¹ Law of Ukraine No. 361-IX “On the Prevention and Countermeasures against the Legalization (laundering) of Proceeds Obtained Through Crime, the Financing of Terrorism and the Financing of the Proliferation of Weapons of Mass Destruction.” (2019, December). Retrieved from <https://zakon.rada.gov.ua/laws/show/361-20#Text>.

² Law of Ukraine No. 3637 “On Virtual Assets”. (2022, February). Retrieved from <https://zakon.rada.gov.ua/laws/show/2074-20.#Text>.

and marketplaces, define the place and role of the banking system in this matter, and provide for state control and monitoring to a certain extent. In the author's opinion, the temporary suspension of the implementation of legal instruments that would make it possible to regulate the creation and circulation of virtual assets in Ukraine legally was due to the simultaneous steps taken by the EU, which in April 2023 approved the MiSA¹ regulation on virtual assets to systematise this issue in the Union. It was the need to harmonise Ukrainian legislation with EU legislation on this issue that led to the suspension of legislative steps in this direction in Ukraine and the adoption of a wait-and-see attitude towards the adoption of basic rules in the EU. So far, there is no MIA as a coherent legal framework that can be used, but it should be expected soon, which will open up the possibility for Ukrainian legislators to synchronise these rules with the norms of Ukrainian legislation.

The need for additional regulatory instruments and the use of existing developments on this issue in Ukraine was confirmed by the launch of cooperation with the world's leading crypto exchanges by the National Agency of Ukraine for Finding, Tracing and Management of Assets Derived from Corruption and Other Crimes (ARMA). In particular, to improve the efficiency of its activities, the Agency has declared in its priorities that it will develop in the direction of financial analysis, creation of its IT laboratory, international cooperation and cooperation with law enforcement agencies, collection of information from open sources, informatisation, automation and optimisation of its functions in this area (Educational and qualification potential..., n.d.).

Summarising different points of view on the perception of virtual assets, it is proposed to divide them into the following main forms:

1. can be tokenised as tokens of crypto projects or crypto networks;
2. can take the form of Non-fungible tokens (NFTs), i.e., they can contain visual, sound, or other value that is perceived by sound, sight, etc;
3. can be a cryptocurrency if it is recognised by the Central Bank of Digital Currency (CBDC) at the state level – a digital currency issued by the state and backed by it.

According to the author, the common feature of virtual assets is that the system of their circulation is ensured by technical decentralisation, i.e., the absence of a single point of management of the circulation process. Virtual assets are intangible and exist as a digital code based on mathematical algorithms. Transactions with them take place based on limited anonymity (tracking is possible with the help of specialised scanner algorithms if the wallet address of the sender/recipient of the asset is linked to a specific individual/legal entity

through KYC (know your customer) verification, which is common in banking and stock exchange regulation). Transaction recording is unconditional and irrevocable and is carried out using blockchain technology. At the same time, due to limited state regulation, the asset or value is provided exclusively by venture capital instruments, supply and demand, the authority of the issuer/developer/implementer team, etc.

As of 2023, no unified international legal regulation of this area exists, except for some attempts and scattered documents at the EU or US level, but the further this issue is being addressed, the more attention is being paid to it. The decentralised nature of the virtual asset sector makes it difficult for states to supervise and control the new market and system, which is only growing in capitalisation and contains financial risks, without additional legal regulation.

The development of unified rules and international legal regulation of the circulation of virtual assets should be preceded by the definition of their concept, classification of forms, identification of common and general features, peculiarities of safe circulation, technical support of the process itself, generalisation of tools to combat abuse, money laundering, and the nature of taxation. After that, it is worth looking for answers to derivative issues, such as the activities of crypto exchanges, crypto exchanges from fiat currency to virtual assets and vice versa, the mechanism for implementing CBDC, and the procedure for tokenising assets. The introduction of a full-fledged circulation of virtual assets in Ukraine should first be preceded by clear international rules in this area since the nature of the movement of these assets is not limited by borders. These rules, among other things, should be the basis for creating clear and understandable legal and procedural instruments. Such instruments may include procedures, rules, guidelines, etc., the use of which will enable specially authorised bodies in this area to both counteract abuses and record, track and qualify relevant illegal acts.

The Ukrainian legal regulation of virtual assets must necessarily regulate the issue of determining the status of crypto secrecy analogous to banking secrecy, establishing its boundaries, subjects of use, restriction, or access to it. The combination of this secrecy with the restriction of anonymity, for the security of the use of virtual assets, namely the linking of crypto wallets to individuals or legal entities to establish the causal link between actions related to their use, will make it possible to introduce and enforce legal liability for violations in this area. The creation of software systems based on internationally recognised norms and rules that would enable the interstate exchange of information between

¹ Position of the European Parliament EP-PE_TC1-COD(2020)0265 "Adopted at first reading on 20 April 2023 with a view to the adoption of Regulation (EU) 2023/... of the European Parliament and of the Council on markets in crypto-assets, and amending Regulations (EU) No. 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937". (2023, April). Retrieved from https://www.europarl.europa.eu/doceo/document/TC1-COD-2020-0265_EN.pdf.

specialised bodies established for this purpose would make it possible to introduce technical monitoring and analysis of the circulation of virtual assets through the use of “digital tracking” of assets whose circulation is accompanied by risks. Systematising the ways of recording the facts of abuse in the use of virtual assets, blocking, or restricting their circulation, and introducing specialised registers of virtual assets and tools for their use would create the preconditions for training specialists who would ensure that the interests of the state are respected above all.

The absence of a clear legal definition of cryptocurrency at the international level leads to the search for such a definition by Ukrainian experts and scholars. S. Vasylychak *et al.* (2017) perceive cryptocurrency as a derivative of the English “cryptocurrency”, i.e., a virtual currency protected by cryptography, revealing its meaning as a fast and reliable system of payments and money transfers based on the latest technologies that are not controlled by any government. V.H. Soslovskyy & I.O. Kosovskyy (2016) characterise cryptocurrency as an innovative product with the features of a tool for making payments in a virtual form, based only on software algorithms with the use of cryptographic methods of their protection and access. T. Zheliuk & O. Brechko (2016) propose the perception of cryptocurrency as a universal tool for making interstate payments without any restrictions, at the level of both legal entities and individuals. The authors describe it as an instrument with a significant market capitalisation, which should be considered as a form of international transfer of assets and capital. This statement is conditionally confirmed by A. Wadsworth (2018), who believes that digital currency can take different forms based either on the existing payment infrastructure technology or on new crypto technology. Given these definitions and characteristics, the author suggests that when defining a cryptocurrency, the fact that it is not a currency in the broad sense, but rather a type of virtual asset, a means of accumulating and transferring the corresponding value, should be considered. Cryptocurrencies should be considered as a currency only after they are introduced and recognised by a particular state as a CBDC.

The views expressed by the author are consistent with the proposals of V.I. Mykhailovskiy & O.V. Kostuk (2019) regarding the development of uniform international legal documents in this area and the implementation of the principles of CBDC implementation at the level of individual states. An example would be the identification of universally recognised international organisations such as the FATF, which could provide interstate information exchange to prevent abuse in this area. At the same time, we should also agree with V.O. Mandryk & V.P. Moroz (2019), who point out that the circulation of virtual assets should not contradict the main legislative and bylaw regulations, and the most effective model of regulation should be their

integration as a phenomenon, “embedding”, into the current legislation of Ukraine.

The study confirms the findings of I. Spilnyk & O. Yaroshuk (2020) that virtual assets, as an uncontrolled and non-personalised means of exchange, payment, and accumulation, are a challenge to any centralised banking system, specialised and law enforcement agencies in their attempts to have all the information about the asset and its movement. However, it is important to remember that this is a completely new and not fully explored factor that can radically change the monetary and financial and monetary policy of any country.

The potential problems of uncontrolled circulation of virtual assets, outlined by the author, complement the comments of several foreign researchers, in particular I. Adam & M. Fazekas (2021). They note that where legal regulation of any system is absent or imperfect, attempts to abuse it appear. The sphere of virtual assets circulation is no exception. Existing information and communication technologies already create opportunities for corruption or money laundering through the movement of virtual assets. The potential danger from the lack of regulation of the circulation of virtual assets, as noted by the author, is confirmed by the study of S. Wagman (2022), who examines virtual assets as a possible haven for criminals, terrorists and those who evade sanctions. It is important to emphasise that the romantic attitude to blockchain technology, anonymity, lack of borders and state control are nothing more than new opportunities for quick and cheap transfers of virtual values, including for illegal acts.

Conclusions

The introduction of various payment systems has created completely new and convenient opportunities for remote payments, simplifying both business operations and making it more convenient for consumers to receive services or purchase goods. The integration of blockchain technology into everyday life as the next stage of harnessing the potential of digitalisation will create additional opportunities for the use of digital technologies, primarily due to their inherent speed and information capacity.

The absence of effective legal regulation of this area, while creating additional and potential opportunities for the economy, finance, and banking sector, in its current form poses more threats than benefits. In the existing legal framework, virtual assets can be fully used as a tool for laundering the proceeds of crime, cross-border and uncontrolled transfer to another territorial jurisdiction and use for an uncertain purpose, both in Ukraine and abroad. It is emphasised that the few attempts to regulate the circulation of virtual assets that have been made in the USA, Austria and the European Union are still fragmentary, not adapted to each other and do not consider the differences in the

degree of their technological development concerning each other. The generalised and already recorded facts related to the risks of circulation of virtual assets indicate a significant criminal potential and the creation of preconditions for their use within the shadow economy and international terrorism in particular. It is emphasised that optimisation of existing and legal ways of using fiat currency, with their use in virtual financial circulation, is not without drawbacks and threats to the financial and monetary policy of any state.

Advantages and concerns of cryptocurrency are highlighted – cryptocurrency issued and provided by the relevant state may give it an unlimited opportunity to monitor its users (owners). If such control is exercised, it is possible to set restrictions on its spending or use (movement) by programming appropriate restrictions (for example, only for education or payment

of housing and communal services, food, medicine, entertainment, etc.) Conversely, the possibility of total transaction tracking to prevent abuse in the shadow economy sector is an absolute positive, but only if appropriate legal safeguards are in place.

The author's recommendations can be used in law-making to create new institutions or improve existing ones. Further elaboration and resolution of these issues will make it possible to perceive and use virtual assets as a benefit and use only their positive aspects while preventing abuse associated with their circulation.

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Conflict of Interest

None.

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Правовий генезис обігу віртуальних активів в Україні та світі: ризики та застереження

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Анотація

Особливості створення та обігу віртуальних активів в умовах їх децентралізованого характеру, обмеженого правового регулювання зумовлюють не лише науковий, а й практичний інтерес з боку як держав, так й інших суб'єктів, які мають можливість і бажання їх використовувати у своєму повсякденному житті. Формування повноцінного світового та національних ринків віртуальних активів є надзвичайно важливим кроком у контексті використання переваг цифровізації, однак створення таких ринків має бути прозорим, що без належного правового регулювання забезпечити не вдасться. Мета статті полягає в дослідженні правового регулювання та розкритті змісту віртуальних активів як явища й інструменту з позицій їх функціональної характеристики та ризиків, що можуть виникати під час їх обігу, зловживань у цій сфері та світового досвіду боротьби з ними. У процесі дослідження використано такі методи наукового пізнання, як порівняльно-правовий, аналізу, формально-логічний та синтезу, що дали змогу проаналізувати законодавство Європейського Союзу й інших країн, практику діяльності спеціалізованих регуляторних органів Великої Британії та Сполучених Штатів Америки щодо їх впливу на обіг віртуальних активів. Проведено паралелі зі спробами ведення нормотворчих процесів в Україні та синхронізовано їх із нормотворчою роботою на міжнародному рівні щодо створення нового понятійного та регуляторно-правового апарату, намагання урегулювати статус віртуальних активів. Висловлено низку пропозицій, реалізація яких створить передумови для розроблення, затвердження та впровадження належного правового регулювання обігу віртуальних активів в Україні. Реалізація їх уможливить міждержавний обмін інформацією з метою недопущення зловживань у досліджуваній сфері діяльності, зокрема легалізації (відмивання) коштів. Результати дослідження може бути використано для формування державної політики й удосконалення законодавства у сфері обігу віртуальних активів

Ключові слова:

цифровізація; блокчейн; криптовалюта; токен; децентралізовані фінанси; Markets in Crypto-assets; Central bank digital currency