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# Blockchain 2023

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## **Cyprus: Law & Practice and Trends & Developments**

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# CYPRUS

## Law and Practice

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Kinanis LLC has been offering legal and consulting services in Cyprus since 1983, evolving from a traditional law firm to an innovative cutting-edge multidisciplinary law firm that combines exceptional expertise in law, tax and accounting. From its establishment, the firm's focus has been heavily business oriented and always abreast with the latest global developments and innovations. Kinanis LLC is committed to providing top-quality legal, tax planning and accounting services tailored according to each client's particular needs, based on experi-

ence and expertise. The practice areas include corporate and commercial law, litigation, employment law, M&A and corporate reorganisations, tax advisory and compliance, transfer pricing, VAT, banking and finance, financial services, funds and regulatory compliance, capital markets and listings, accounting, immigration, trusts, estate planning and succession, anti-money laundering and regulatory compliance, blockchain consulting, intellectual property, data protection and privacy, and real estate.

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## 1. Blockchain Market and Business Model Overview

### 1.1 Evolution of the Blockchain Market

Blockchain has been mainly popular in projects of the financial services industry, including crypto-related projects. The recently adopted Markets in Cryptoassets Regulation and the Distributed Ledger Technology Pilot Regime by the European Union is expected to create new business models utilising blockchain technology.

Nevertheless, there has been an increasing interest for use cases utilising blockchain technology outside the ambit of financial services, such as the development of a platform aiming at food traceability of Cypriot local and traditional products and the deployment of blockchain technology in the electricity market in Cyprus.

There has been a collective mission to separate blockchain technology from the crypto element and thus the initiatives on real uses cases. The bankruptcies of crypto exchanges played a role in this, however, this has not disrupted the market in Cyprus, since the regulator acted promptly to protect investors and the market's reputation.

### 1.2 Business Models

Blockchain is mainly used as the underlying technology by businesses in the finance and regulatory tech industry. The main applications of blockchain relate to the provision of crypto-asset services, record-keeping of transactions and KYC procedures. During 2022, eight crypto-asset service providers were registered with the Cyprus Securities and Exchange Commission, including crypto-exchange platforms.

### 1.3 Decentralised Finance Environment

Decentralised finance protocols have not been widely used in Cyprus so far, since there are no specific regulations for such protocols. However, certain DeFi protocols such as decentralised lending platforms, wallet aggregators, etc, are accessible to Cyprus residents.

### 1.4 Non-fungible Tokens

There has been an increased interest by people in Cyprus regarding NFTs, however there has not been development of NFT marketplaces or platforms for their creation in Cyprus.

It is expected that the use of NFTs will create implications regarding the ownership of NFTs, as well as intellectual property rights.

## 2. Regulation in General

### 2.1 Regulatory Overview

Currently, there is no specific legislation regarding blockchain, its application and its use.

#### The Anti-Money Laundering Law

The implementation of the 5th Anti-Money Laundering European Union Directive in February 2021, into the Cyprus Anti-Money Laundering Law, introduced crypto-assets into the Cyprus legislation for the first time. The law defines crypto-assets as a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money but is accepted by persons as a means of exchange or investment and can be transferred, stored or traded electronically and is not:

- fiat currency;
- electronic money; or
- financial instruments as defined in Part III of the First Appendix of the Law on the Provision of Investment Services and Activities and Regulated Markets.

According to the Anti-Money Laundering Law, a crypto-asset service provider providing one or more of the following services is obliged to be registered with the Cyprus Securities and Exchange Commission unless it is a crypto-asset service provider established and registered in a member state of the EU. The services that a crypto-asset service provider may undertake are:

- exchanges between crypto-assets and fiat currencies;
- exchanges between crypto-assets;

- the management, transfer, holding or safe-keeping, including custody, of crypto-assets or cryptographic keys or means that allow the exercise of control on crypto-assets;
- the offering and sale of crypto-assets, including the initial offering; and
- the participation or provision of financial services regarding the distribution, offer and sale of crypto-assets, including the initial offering.

Financial services regarding the distribution, offer and sale of crypto-assets include the following services:

- the reception and transmission of orders;
- the execution of orders on behalf of clients;
- dealing on own account;
- portfolio management;
- the provision of investment advice;
- underwriting or the placing of crypto-assets on a firm commitment basis;
- the placing of crypto-assets without a firm commitment basis; and
- the operation of a multilateral trading facility for buying and selling crypto-assets.

#### European Union Markets in Crypto-Assets Regulation

In April 2023, the European Union adopted the Markets in Crypto-assets Regulation (MiCAR) regulating crypto-assets not falling within the existing financial services legal framework; ie, asset-reference tokens, e-money tokens and utility tokens. The adoption of MiCAR creates a bespoke regime for such crypto-assets, leading to legal certainty and security.

Further, MiCAR introduces uniform rules for the licensing and operation of crypto-asset service providers for services relating to the crypto-assets regulated by MiCAR. The regulation also establishes rules for the enhancement of con-

sumers' protection through the establishment of strong requirements for the provision of crypto-asset services.

MiCAR is directly applicable to all member states of the European Union, thus creating a uniform legal framework for the crypto-assets falling within its scope. In effect, it is expected that the existing national rules of the member states will be replaced by the provisions of MiCAR.

## 2.2 International Standards

In general, obliged entities under the Anti-Money Laundering Law, such as crypto-asset service providers, must follow the provisions of the law as described above, and the guidelines issued by the Cyprus Securities and Exchange Commission and the Central Bank of Cyprus, which are in line with the recommendations or standards proposed by the Financial Action Task Force.

## 2.3 Regulatory Bodies

The main regulatory bodies in Cyprus that are relevant to the use of blockchain within the ambit of financial services are the Cyprus Securities and Exchange Commission and the Central Bank of Cyprus.

The scope of their supervision, based on a technology neutral-based approach, is to supervise the companies that fall under their regulatory ambit and use the blockchain or other technology in carrying out their regulated activities.

Further, the Cyprus Securities and Exchange Commission is responsible for the supervision of crypto-asset service providers, registered in accordance with the Anti-Money Laundering Law. It is expected that the Cyprus Securities and Exchange Commission will be the designated competent authority under MiCAR for the

licensing and supervision of the crypto-asset service providers.

The Central Bank of Cyprus is also active in the discussions regarding the application of blockchain in the banking services industry. The Central Bank also issues regular warnings to the public regarding the volatility of crypto-assets and their risks.

Another important stakeholder to the promotion of blockchain and other technologies is the Deputy Ministry of Research, Innovation and Digital Strategy. Its responsibility is to develop and implement a national digital policy in Cyprus and to participate in the establishment of an enabling ecosystem for private and public use cases.

## 2.4 Self-Regulatory Organisations

There are no non-governmental organisations that exercise regulation specifically on the use of blockchain per se. There are trade groups that aim to educate their members as to the use of blockchain in various industries.

The Cyprus Blockchain Technologies (CBT) is a private, non-profit and autonomous think-tank organisation with no regulatory power, which was established to unite the Cyprus community of blockchain stakeholders from all industries and sectors. CBT has been, and still is, an important stakeholder in the promotion of blockchain and other distributed ledger technologies in Cyprus actively providing a valuable source of education, training and know-how on the matter.

## 2.5 Judicial Decisions and Litigation

There have not been any important judicial decisions on the use of blockchain, smart contracts or the use of such technology at large. The current ongoing disputes relate mainly to crypto

claims as a result of fraud and mismanagement of wallets.

## 2.6 Enforcement Actions

There is no law and probably there will never be a law regulating the technology as such, as this will hinder innovation and promotion of new technologies. We expect though to see court decisions relating to cases of stolen cryptos and wallets which may help set the parameters of crypto-assets service provider and investor protection.

## 2.7 Regulatory Sandbox Innovation Hub

In 2018, the Cyprus Securities and Exchange Commission launched its innovation hub, to create communication channels between the Cyprus Securities and Exchange Commission and entities, both in Cyprus and abroad, which are involved in fintech and regtech. By applying to the innovation hub, an entity can receive an opinion on how its product will be treated under the existing regulations.

## Regulatory Sandbox to Enable Fintech

In 2022, the Cyprus Securities and Exchange Commission issued a public tender for the establishment of a regulatory sandbox to facilitate innovation in fintech and regtech. It is expected that the sandbox will be established in the next couple of years.

## 2.8 Tax Regime

Cryptocurrencies are not considered as a currency in Cyprus and there is no specific tax provision in place for their treatment just yet. Therefore, it is expected that cryptocurrencies will be taxed based on their nature and characteristics. In effect, crypto-assets characterised as security tokens shall be treated differently from crypto-

assets characterised as utility tokens or payment tokens.

## 2.9 Other Government Initiatives

An ad hoc committee consisting of lawyers, technical experts and other related professionals was established to create guidelines relating to the drafting of the Bill on Distributed Ledgers Technology and to recommend use cases of the blockchain technology.

## 3. Cryptocurrencies and Other Digital Assets

### 3.1 Ownership

Currently, there are no specific rules relating to the ownership of digital assets, nor any decision as to whether digital assets constitute property in Cyprus. Where digital assets are held in a digital wallet, the person holding the private key to that wallet may be defined as the owner of the digital assets.

### 3.2 Categorisation

In the absence of any specific national legislation, crypto-assets are categorised pursuant to their characteristics and rights they confer to their holders. The definition of crypto-assets in the Anti-Money Laundering Law may serve as a guidance for the categorisation of crypto-assets. Crypto-assets are defined as a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money but is accepted by persons as a means of exchange or investment and can be transferred, stored or traded electronically and is not:

- fiat currency;



- electronic money; or
- financial instruments as defined in Part III of the First Appendix of the Law on the Provision of Investment Services and Activities and Regulated Markets.

### 3.3 Stablecoins

There are no precise rules and regulations in Cyprus regarding stablecoins. The issuance and investment in stablecoins depend on the type of asset to which the stablecoin is pegged.

### 3.4 Use of Digital Assets

In Cyprus, certain businesses and individuals accept payments made with cryptocurrencies. However, due to the absence of specific rules regarding such payments, this payment method is not widely used.

### 3.5 Non-fungible Tokens

No specific rules are available for the creation, marketing or sale of NFTs in Cyprus. Further, tax laws do not clarify how NFTs will be taxed.

## 4. Exchanges, Markets and Wallet Providers

### 4.1 Types of Markets

There are several exchanges and marketplaces available for users in Cyprus, both custodial and non-custodial, as well as decentralised exchanges. In general, custodial exchanges operating in Cyprus as crypto-asset service providers, require users to complete the relevant KYC procedures, unlike non-custodial exchanges which do not require users to follow such procedures.

Further, in Cyprus, the markets for digital assets are still developing, even though there are several exchanges and marketplaces available.

### 4.2 On-Ramps and Off-Ramps

The exchange of fiat currency for cryptocurrencies and vice-versa is done through crypto-exchange platforms, which are either centralised or decentralised.

Crypto-exchange platforms must get registered with the Cyprus Securities and Exchange Commission, as crypto-asset service providers. Entities which facilitate the exchange of fiat-to-crypto and crypto-to-fiat are subject to AML and CFT financing regulations. Depending on the type of cryptocurrencies involved in the exchange, the crypto exchange entity may be subject to securities regulations, including licensing requirements.

### 4.3 KYC/AML/Sanctions

Crypto-asset service providers are considered as obliged entities and are subject to anti-money laundering laws. The relevant AML/KYC rules are set out in the Prevention and Suppression of Money Laundering and Terrorist Financing Law of 2018, which transposes the EU's Fourth Money Laundering Directive (4AMLD) into Cyprus law.

Pursuant to the law, crypto-asset service providers, including exchanges and custodial wallet providers, are required to verify the identity of their customers and conduct due diligence on their transactions. They must also establish internal AML/CFT policies and procedures, appoint a compliance officer, and report suspicious transactions to the relevant authorities.

Cyprus also enforces economic and trade sanctions imposed by the United Nations and the European Union. These sanctions apply also to digital assets transactions and are implemented by the Central Bank of Cyprus in collaboration with other relevant authorities.

Cyprus has also implemented regulations that specifically address crypto-assets, including the Cyprus Securities and Exchange Commission's guidance on the regulation of crypto-assets. The guidance provides an overview of the application of existing financial regulations to cryptocurrencies and related activities, including licensing requirements for crypto-exchanges and the treatment of crypto-assets under securities laws.

#### 4.4 Regulation of Markets

The markets for digital assets in Cyprus are regulated by multiple authorities, including the Cyprus Securities and Exchange Commission and the Central Bank of Cyprus.

The Cyprus Securities and Exchange Commission is the primary regulatory body for digital assets and oversees their trading, issuance and offering to the public, since it supervises crypto-asset service providers. The guidelines governing the operations of such providers govern a variety of areas such as investor protection, anti-money laundering and risk management.

Even though there have not been many enforcement actions in Cyprus in relation to crypto-assets, there have been some cases of fraudulent activities for initial coin offerings. In this respect, Cyprus Securities and Exchange Commission issues warnings relating to crypto-assets from time to time.

#### 4.5 Re-hypothecation of Assets

Currently, there are no specific regulations in Cyprus that address the re-hypothecation of digital assets held by a digital asset exchange on behalf of its customers. However, the general legal principles of agency and fiduciary duty may apply to the relationship between a digital asset exchange and its customers.

#### 4.6 Wallet Providers

Currently, there are no specific regulations in Cyprus applicable to businesses that provide online or offline storage solutions. Depending on the line of business, existing laws may be applicable.

### 5. Capital Markets and Fundraising

#### 5.1 Initial Coin Offerings

An entity offering and/or selling crypto-assets, including an initial offering not falling under any other existing regulatory framework, must get registered as a crypto-asset service provider with the Cyprus Securities and Exchange Commission.

Further, when launching an ICO, an entity should consider very carefully the existing regulatory framework, taking into consideration:

- whether tokens issued are considered securities or financial instruments under MiFID II and generally MiFID II compliance;
- whether it falls within the provisions of the Prospectus Directive;
- whether it may qualify as a licensed investment scheme;
- compliance with legislation on AML and GDPR; and
- possible tax implications for the parties involved.

#### 5.2 Initial Exchange Offerings

The regulations applicable to fundraising through the sale of tokens by using a digital asset exchange as an intermediary is subject to regulations set by the Cyprus Securities and Exchange Commission. Securities regulations may be applicable depending on the nature of the tokens.

## 5.3 Other Token Launch Mechanisms

There are no different rules on the treatment of the distribution of crypto-assets by airdrop or by any other means.

## 5.4 Investment Funds

There are no special regulations at a national level applicable to crypto funds other than the restrictions applicable under the EU Alternative Investment Funds Managers Directive. In practice, the Cyprus Securities and Exchange Commission allows only alternative investment funds with a limited number of persons to be created as crypto funds. As for investments in digital assets that could be characterised as securities, the same rules as private equity funds would apply.

## 5.5 Broker-Dealers and Other Financial Intermediaries

Broker-dealers must be registered with the Cyprus Securities and Exchange Commission as crypto-asset service providers.

## 6. Smart Contracts

### 6.1 Enforceability

Due to the absence of a legal framework and a precedent by the courts as to how smart contracts should be treated, there are no guidelines as to what extent smart contracts are enforceable legal contracts under Cyprus law. In cases where smart contracts do not create novel legal issues as to their legality and enforceability, then they should be treated as traditional contracts. Certain issues may arise when smart contracts create novelty due to their automatic and irreversible nature.

The modernisation of some pieces of existing legislation is imperative to integrate smart contracts in the legal system of Cyprus.

## 6.2 Developer Liability

There has not been any guidance in Cyprus so far regarding the liability of developers.

## 7. Lending, Custody and Secured Transactions

### 7.1 Decentralised Finance Platforms

There is no specific legal framework addressing the operation of DeFi platforms at the moment. Although MiCAR in principle does not apply to DeFi, in DeFi projects that have some degree of centralisation by having an identifiable intermediary, such intermediary could be liable under MiCAR provisions.

### 7.2 Security

It is not common at all for traditional lending institutions to accept digital assets as collateral to loans.

### 7.3 Custody

The safekeeping and custody of crypto-assets falls within the ambit of AML provisions as described above. Any legal person acting as custodian of crypto-assets must be registered as CASP with the Cyprus Securities and Exchange.

## 8. Data Privacy and Protection

### 8.1 Data Privacy

To the extent possible, the European Union General Data Protection Regulation (GDPR) must be applicable to blockchain-based products. It is evident that the decentralised and immutable nature of blockchain conflicts with the provisions

of the GDPR, such as the right to be forgotten. Due to the immutable character of blockchain, compliance with data privacy and data protection may be problematic and therefore, it should be something to be taken into consideration during the development of a blockchain which will include personal data.

## 8.2 Data Protection

Please see 8.1 Data Privacy.

## 9. Mining and Staking

### 9.1 Mining

There are no specific laws regarding mining activities in Cyprus and mining is not characterised as an activity which requires the granting of a licence or the registration with the Cyprus Securities and Exchange Commission.

### 9.2 Staking

Staking of tokens is not regulated in Cyprus so far.

## 10. Decentralised Autonomous Organisations (DAOs)

### 10.1 General

There are no specific national regulations governing the operations of DAOs other than the ones applicable to the token issuance and crypto-assets under the AML regime. In effect, the use of DAOs within the national financial ecosystem is not so common given the absence of any traditional governance rules.

### 10.2 DAO Governance

Given the decentralised nature of DAOs, it is not easy to assess the activity of DAOs in any jurisdiction. Due to the legal uncertainty as to the use of DAOs, off-chain elements still form part of such organisation. This is not a trend only in Cyprus.

### 10.3 Legal Entity Options

It is more common to see issuers in the form of legal entities such as limited liability companies or investment schemes, rather than DAOs being at the core of the structures, due to governance rules not being in place. Using legal entities defeats the purpose of decentralisation, however, from a legal perspective, provides certainty, and in most cases, regulation.

## Trends and Developments

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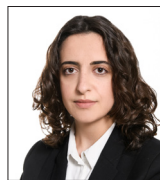
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### Introduction

Cyprus has been gradually developing its blockchain ecosystem, with a number of key actions and developments.

In May 2019, the Cyprus government launched its National Blockchain Strategy (NBS), aiming to promote the development of blockchain through innovation and the co-operation between the public and private sector. The government identified the needs of the market, by collaborating with entities, and committed to implement the NBS. Along with the adoption of the NBS, Cyprus has signed the European Blockchain Partnership and the Declaration of the Southern Mediterranean Countries on Distributed Ledger Technologies, to empower the co-operation with parties abroad.

The Cyprus government had set as a priority to establish Cyprus as a technological hub, through the enhancement of the application of technology by both the private and public sector. The optimisation of the services offered by the public and private sector could be achieved with the introduction of blockchain to areas of interest, such as the financial services sector, including compliance and KYC procedures, the education system, the land registry and the national health system.

### Financial Services

Even though there is no legal framework governing the application of blockchain in Cyprus, there has been an immense interest, particularly from entities in the financial and regulatory technology space that use blockchain as a core technology.

For the first time in 2021, the Anti-Money Laundering Law introduced crypto-assets and crypto-asset service providers in the Cyprus legal framework.

According to the provisions of the AML Law, a crypto-asset is “a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by persons as a means of exchange or investment and which can be transferred, stored or traded electronically and that is not:

- fiat currency;
- electronic money; or
- financial instruments as defined in Part III of the First Appendix of the Law on the Provision of Investment Services and Activities and Regulated Markets”.

Further, under the AML Law, crypto-asset service providers (CASPs) providing services in or from Cyprus, are considered as obliged entities with relevant anti-money laundering obligations. In effect, CASP providing one or more of the following services is obliged to get registered with the Cyprus Securities and Exchange Commission, unless it is a CASP established and registered in a member state of the EU. In such case, the CASP must follow a notification procedure. The relevant services are:

- exchange between crypto-assets and fiat currencies;
- exchange between crypto-assets;
- management, transfer, holding and/or safe-keeping, including custody, of crypto-assets or cryptographic keys or means which allow the exercise of control on crypto-assets;
- offering and/or sale of crypto-assets, including the initial offering; and
- participation and/or provision of financial services regarding the distribution, offer and/or sale of crypto-assets, including the initial offering.

Financial Services regarding the distribution, the offer and/or the sale of crypto-assets means the following services and activities relating to crypto-assets:

- reception and transmission of orders;
- execution of orders on behalf of clients;
- dealing on own account;
- portfolio management;
- provision of investment advice;
- underwriting and/or placing of crypto-assets on a firm commitment basis;
- placing of crypto-assets without a firm commitment basis; and
- operation of a multilateral trading facility for buying and selling crypto-assets.

Following that, the Cyprus Securities and Exchange Commission issued a policy statement on the registration and operations of crypto-asset service providers, clarifying how blockchain-based solutions could be used within the existing regulatory framework. Further, Cyprus has seen a rise in cryptocurrency adoption in recent years, with an increasing number of businesses and individuals accepting cryptocurrencies as a payment method.

### Education and Training

It is worth mentioning that Cyprus is home to several blockchain education and training initiatives, aimed at fostering the development of local blockchain talent. These initiatives include the Cyprus Blockchain Technologies, a non-governmental think-tank, which provides training and education programmes for blockchain developers, as well as the University of Nicosia's Blockchain Initiative, which offers a range of blockchain-related courses and degrees.

Further, the Cyprus Bar Association, through its Technology Committee, organises seminars for lawyers, providing guidance regarding new technological advancements.

### Blockchain-Based Solutions

There has been a growing number of blockchain-based solutions being developed in Cyprus, with a focus on areas such as supply chain management, healthcare and identity verification. These solutions are being developed by both local startups and international companies setting up operations in the country.

### State General Laboratory

The State General Laboratory of Cyprus initiated a competition for the development of a platform aimed at food traceability of Cypriot local and traditional products using decentralised tech-



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nology (eg, blockchain). The platform will be supported by the existing isotopic database of Cypriot local and traditional food/drinks. The use of decentralised technology ensures the identity, authenticity, quality and security of products. The platform will be developed within the framework of the “IsoDataBase” project.

### *Cyprus Energy Regulatory Authority*

The Cyprus Energy Regulatory Authority initiated a call for tender on consultancy services for establishing guidelines on the deployment of blockchain technology in the electricity market in Cyprus.

### **Regulatory Sandbox and New Trends**

The above-mentioned use cases, the upcoming creation of a regulatory sandbox by the Cyprus Securities and Exchange Commission and the upcoming European pieces of legislation, are stepping stones to strengthen Cyprus’ position as the home for many tech companies.



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