

The Advancement of the Blockchain and Cryptocurrency industry in Cyprus.

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## **Abstract**

The world is experiencing the fourth industrial revolution through the development of blockchain and cryptocurrencies. The adaptation of technology in these sectors has never seen a development to the extent we are seeing today. Blockchain is a technology for promoting user trust. It allows for the possibility of sharing online information, record transactions in a verifiable, secure, and permanent way. The technology is already being successfully tested, mostly in financial services, and will become more operational and integrated into an increasing number of digital services, such as regulatory reporting, energy and logistics in the coming years.

Currently, Europe holds the second most significant share in the blockchain technology market and Cyprus is at the heart of this. Cyprus is considered a prime location for the Fintech industry and a haven for pioneering blockchain start-ups. The Cypriot government is taking a very positive stance on digital currency and infrastructure for the growth of talent in this area. Alongside this Cyprus has become one of the most considered countries for blockchain businesses, mostly because of the islands attractive tax system.

The Republic of Cyprus signed the ‘European Blockchain Partnership’ and the ‘Declaration of the Southern Mediterranean Countries on Distributed Ledger Technologies’, with the aim of enhancing cooperation in the digital sector and rendering Southern Europe a leader in emerging technologies such as distributed ledger technologies (DLT). However, one must point out there is no comprehensive legal framework in place governing blockchain and cryptocurrencies, but the country has no expressed any interest in restricting or banning them. Throughout the years, European Union policies have been accepting towards cryptocurrencies, unlike other economic areas where there are bans and restrictions imposed.

This paper will analyse the developments of this industry in Cyprus and what the government has done to be more accepting of Fintech in terms of social, economic, and political aspects.

## **1. The development of Blockchain and Cryptocurrencies in Cyprus**

### **1.1 CYSEC Innovation Hub**

The Cyprus Securities and Exchange Commission (CySEC) has established an Innovation Hub which aims to act as a platform for both supervised and non-supervised entities to come together and share knowledge in order to accelerate their business models in line with the CySEC's commitment to ensuring regulated entities' investor protection. The Innovation Hub offers support to market participants who are introducing innovative financial products or services. This is to help Cyprus achieve its aim of becoming one of Europe's leaders in innovative technologies. The Innovation Hub focuses on Fintech and Regtech, including the utilisation of Blockchain and other DLT technologies. Fintech is the term used to describe any technology that delivers financial services through software, such as online banking, mobile payment apps or even cryptocurrency. In comparison, Regtech consists of a group of companies that use cloud computing technology through software-as-a-service to help businesses comply with regulations efficiently and less expensively. Regtech is also known as regulatory technology. The Innovation Hub is designed to address and explore the rise of Fintech and Regtech developments and to foster a more effective relationship between FinTech companies. Through the project, CySEC is currently investigating technical, legal, and managerial applications of DLT in the services industry.

The Innovation Hub allows for the easy transfer of information, on how existing regulation applies to new products or business models, whilst helping identify what regulatory frameworks might need to be established to meet evolving needs - without stifling innovation. The Innovation Hub is the designated point of contact for Fintech and Regtech

businesses from Cyprus and abroad. There is a dedicated team, which undergoes constant training and development on the Fintech and Regtech issues and assesses inquiries on a first come first-served basis.

Since its inception, the Innovation Hub has engaged with nineteen firms and stakeholders around specific queries and demonstrations of specific solutions. Entities engaging in crypto asset activities were provided with the opportunity to present their policies and procedures to CySEC and received informal steer. Such engagement allowed interested parties to grasp a better understanding of CySEC's expectations, particularly on AML safeguards.

Cyprus can capitalise on its strengths such as the high-quality human capital and national infrastructure to digitize the economy, thereby fuelling growth. In this way, existing international and cross-border transactions can be further leveraged for the implementation of DLT and focus should be geared towards the modernization and the transformation of leading sectors such as energy, shipping, finance, as well as the provision of Public Services.

## **1.2 Invest Cyprus**

Invest Cyprus is the island's national investment agency; it signed a Memorandum of Understanding in October 2018 with the Singapore-registered public blockchain service creator VeChain foundation, as well as the USA-registered blockchain project strategy advisory Cream to further introduce and promote DLT in Cyprus. VeChain Foundation and Cream will partner to advise Invest Cyprus on policy-making that will ensure blockchain's use in investments and economic reform of financial services, in order to improve economic development in Cyprus.

### **1.3 European Union Declarations and Partnerships**

The Republic of Cyprus signed the European Blockchain Partnership on the 4th June 2018 and along with six other European member states (Malta, France, Greece, Italy, Portugal and Spain) signed the joint ‘Declaration of the Southern Mediterranean Countries on Distributed Ledger Technologies’ on the 4th December 2018, with the aim in enhancing the cooperation in the digital sector and to render Southern Europe a leader in emerging technologies such as DLT. The agreement to cooperate in the establishment of a European Blockchain Services Infrastructure (EBSI) will support the delivery of cross-border digital public services, with the highest standards of security and privacy.

The current strategy aims to develop upon these efforts and intentions in order to promote an enhanced understanding and proper implementation of DLT and blockchain technology both by the public and the private sector in Cyprus. The signing of this declaration paves the way for cooperation in the Mediterranean basin for technology-related companies that are based in Cyprus. The Declaration should be utilised in order to absorb available EU funds on DLT technology, especially in the next Multiannual Financial Framework 2021-2027.

Since April 2018, the Partnership has held monthly meetings with the aim to develop a trusted, secure and resilient European Blockchain Services Infrastructure (EBSI) meeting the highest standards in terms of privacy, cybersecurity, interoperability and energy efficiency, as well as being fully compliant with EU law. The Partnership will also develop a set of guiding principles and specifications for the EBSI that will be enhanced to be recognised as a reference for the development of blockchain infrastructures and will propose a model to describe the overall policy and technical governance of the EBSI.

In addition, European Commission is working together with industry and stakeholders. This cross-cutting approach is instrumental to overcome regulatory obstacles,

increase legal predictability, lead international standardisation efforts, and accelerate research and innovation to support innovative blockchain technologies.

#### **1.4 What has Cyprus done?**

The national agenda is wide-ranging, covering everything from tax incentives for Fintech firms, the Cyprus Start-up Visa Scheme and the establishment of a €20 million fund with an emphasis on start-ups and innovative companies.

In August 2018, an ad-hoc Committee was formed, by a Council of Minister's decision, following an initiative of the President of the House of Representatives and the Minister of Finance with the primary objective of drafting the National Strategy that will set out Cyprus's vision for DLT, which is part of Cyprus's wider vision for digital transformation, supporting and advising in the appropriate framework required to enable the transition to DLT/blockchain technologies, as well as identify the key initiatives to drive this transition within a 12-18-month period.

The key objective is to detail the necessary operational planning, as well as the various scenarios and prerequisites, in order to ensure that the CY public sector will be able to utilise the potentials of DLT. The said ad hoc group operates under the supervision of the government of the Republic of Cyprus in close cooperation with the House of Representatives and includes experts and stakeholders from the public and private sectors. The framework must also ensure that the development of such technologies takes into consideration their effects on the labour force of Cyprus, while at the same time addressing the ethical aspects of the use of DLT and blockchain technologies.

The Cyprus Securities and Exchange Commission (CySEC) issued its first regulation regarding cryptocurrencies. Cryptocurrency has an impeccable legal record in Cyprus, and it is recognised as legal tender. The government has no plan to restrict merchants or ban the

service. This improves the ability of consumers to trade goods and services for digital currencies.

The new rules laid down in the first cryptocurrency regulation by CySEC known as Circular C417 are designed to ensure that Cyprus Investment Firms (CIFs), make provisions to cover investments in cryptocurrencies and that risks involving cryptocurrencies are managed properly. CIFs must first obtain authorisation from CySEC to trade in cryptocurrencies because they are not specifically regulated by previous financial regulation, whether in Cyprus or at the level of the EU. Cyprus investment firms, which trade in crypto-assets, and/or in financial instruments relating to crypto-assets, are advised by CYSEC to revisit their risk management procedures and strategies and ensure that all risks associated with this product are duly taken into consideration.

In 2019, Cyprus' cabinet published its National Strategy on Distributed Ledger Technologies. The cabinet sought to provide a platform for both public and public-private initiatives employing blockchain applications. The Strategy provides a framework and a high-level road map for examining the applications of DLT, across different sectors, in the context of process optimisation and cost efficiency, and addresses the risks arising from the emergence of new products utilising DLT.

This National Cypriot strategy on the development and deployment of such technologies addresses a number of issues. It focuses on the creation of a proportionate regulatory framework that accommodates and fosters innovation, provides legal certainty and protection for consumers and investors alike, while preserving technological neutrality.

## **1.5 The development of blockchain in Cypriot universities**

As documented by the European Union Blockchain Observatory and Forum, the academic community in Cyprus, has been active in the blockchain field. The University of Nicosia, in 2015, became the first in the world to offer a master's degree in Digital Currency and a number of blockchain communities, initiatives and start-ups have been evolving over the last few years.

Cyprus' securities regulator recently partnered with the University College London's Blockchain Technology for Algorithmic Regulation and Compliance (BARAC), which researches applications for blockchain technology in automating compliance and regulatory procedures.

More recently, the University of Nicosia has established the Institute for the Future (IFF), which looks at how blockchain will co-exist with other technologies of the 4th Industrial Revolution, especially artificial intelligence, and the Internet of Things. Seminars and lectures on subjects related to blockchain are also hosted regularly by the Cyprus International Institute of Management.

The Cyprus Blockchain Technologies Ltd is a non-profit organisation established as a collaboration among academic institutions, including the Cyprus International Institute of Management (CIIM), University College London Centre for Blockchain Technologies (UCL CBT) and the University of Nicosia, local regulators, financial institutions, and banks, as well as other technology associations and companies.

## **1.6 Uses of blockchain in Cyprus other than in the finance industry**

Blockchain technology allows people and organisations who may not know or trust each other to collectively agree on and permanently record information without a third-party authority. By creating trust in data in ways that were not possible before, blockchain has the potential to revolutionise how we share information and carry out transactions online. Two prime examples of ways the Cypriot community has implemented blockchain into society is in the medical field and in the sports field.

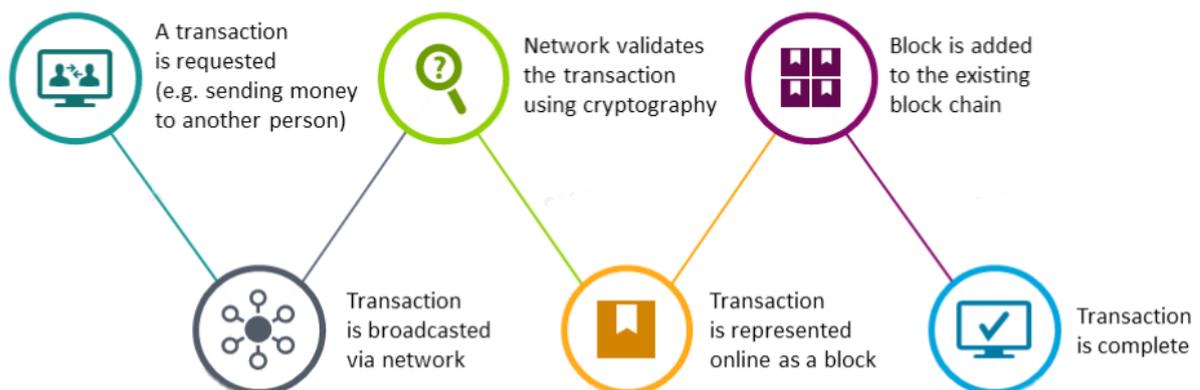
In the medical field, blockchain technology is used to enable medical data to be stored and transmitted securely, safely, and effectively. A hospital in Cyprus has been utilising the VeChain blockchain to store Covid-19 vaccination records. One of the largest private hospitals in Limassol stores the vaccination records on VeChain and also provides a digital vaccination certificate on their E-HCert App which is an electronic wallet for lab results. This is all another step forward to the digital transformation of the health industry. The VeChain technology provides the government, individuals, and health care practices the assurances that their test results are valid. Furthermore, a private hospital in Nicosia has implemented VeChain in its practices. This is because it is the best opportunity to reshape the current model used in terms of medical records and improve the delivery of healthcare, test results, therapeutics, diagnostics as well as advance the process and security of information exchange between parties.

In the sports field, blockchain technology was used to allow fans to choose the formation and the attacking line-up of a Cypriot team. This team allowed fans to use blockchain technology and fan tokens to vote on its match line-up and formation; this was taking fan engagement to a whole new level. With the blockchain website, Socios.com fans bought a token and voted in a series of polls that determined the set-up of the team. It must be added that the team had won that match, it was the first match ever to be powered by

blockchain. The team in question has agreed to continue to allow fans to dictate certain aspects of the team as it provides a connection between the fans and the team. Socio not only collaborated with this Cypriot team but has also formed a partnership with Barcelona, Juventus, and PSG.

These two examples are ways in which blockchain can be used in our everyday life in order to ease the communication between two parties. This indicates that blockchain will be active in our everyday life in the near future, both in a financial aspect but also in a variety of other aspects. Hence, Cyprus has been very willing to introduce blockchain into their society which could also help create a more efficient system within Cyprus whilst attracting more blockchain and fintech companies to establish here due to the willingness of society to integrate technology into our daily lives.

## Blockchain Technology - How It Works Timeline



## **2. The Risk of cryptocurrencies**

The public needs to be aware of the fact that there are no specific regulatory measures to cover losses from the use of virtual currencies if the platform that exchanges or holds them collapses and thus there is the risk of losing the entire amount deposited. Hence, there are a number of risks involved in the cryptocurrency industry. This is mainly because there is a lack of guarantee or legal obligation to reimburse at face value; meaning there is no authority to monitor the transactions or the financial firms creating and selling the cryptocurrency.

Moreover, the price of virtual currencies is highly volatile; as a result, it may rise sharply or even fall to zero value. This means people should do their research before they invest their money in a cryptocurrency; both in the cryptocurrency they invest in but also the platform used. CYSEC create a list of websites that have been found to commit fraud in the cryptocurrency industry. This list is constantly updated and there to help citizens avoid the risk of being a target of fraud and losing all the money they had 'invested'.

Cryptocurrencies do not leave a paper trail on the transactions; this means they are far more likely to be misused for the purpose of illegal activities. Examples include money laundering, tax evasion and terrorist financing activities. This is a key reason for the hesitation in many countries and companies informally accepting and acknowledging cryptocurrencies, as it can be a way to use illegal money in transactions. In addition to this, there is no physical substance to a cryptocurrency hence they are deposited in an e-wallet which could potentially be stolen.

As a brief overview, there are a large number of risks in using and investing in cryptocurrencies, hence the reason for the large hesitation towards it from a variety of governments, companies and individuals. With cryptocurrency, there is no one controlling it hence people believe it is popular due to the moving away from the central bank and establishment in terms of purchasing power. This is because there is no central bank involved

in purchasing or selling the currencies, but it is computers who mine the currencies and sell it; the prices of these currencies change depending on supply and demand meaning it is a move towards a more free-market economy.

### **3. Way forward**

Despite its potential to act as a game changer, DLT is still an often misconstrued and misunderstood concept, still lacking maturity and in many cases remaining undeployed. Issues related to scalability, privacy and confidentiality are slowing down technical advancement, whilst regulatory uncertainties and legal risks continue to exist. However, the promise of a more secure, trusted, efficient and fast way of data storing, and sharing has led to significant investments by both institutions and individuals in understanding how the technology works and how its potential can be unlocked to deliver benefits across industries. Hence, the deployment of DLT/blockchain technologies requires not only a public awareness campaign undertaken by the government in collaboration with the relevant stakeholders and the academic community aimed at educating the citizens on the advantages and the risks that DLT and blockchain entail, in order to prevent instances of abuse, but also a reform of the country's education system in order to prepare future generations to engage with digital technologies. Other challenges that have been identified and relate to DLT concern, the enforceability of smart contracts, the admissibility in Court information stored in DLT as well as GDPR implications.

Notwithstanding its potential to transform the economy and society, DLT/blockchain remains an evolving technology, hence its development and large-scale deployment is impeded by several obstacles such as issues pertaining to the scalability of permission less blockchains, energy consumption required to run proofing algorithms and security concerns where computer advances may render blockchains vulnerable to attacks.

Emphasis should be given to the impact of the DLT/blockchain on the labour market as well as on the availability of training/education programmes which will furnish the labour force with the skills required for the new employment opportunities created by these technologies.

The core advantage of DLT, which is the elimination of intermediaries, thereby allowing industries to redefine or create new business models, necessitates taking action in order to adopt to these new technologies, thereby reinforcing Cyprus' economy. Therefore, the encouragement and adoption of a new business model is deemed to be the way forward for Cyprus, enabling it to preserve and improve its international competitiveness in the services sector, while at the same time addressing the risk posed by DLT and creating new opportunities for investments.

The further development of the Block chain and cryptocurrency industry in Cyprus is strongly dependent on the corporation tax of Cyprus and whether Cyprus will be forced to adopt a global corporation tax. This global tax would mean Cyprus will lose in competitive advantage of having a low corporation tax at 12.5%, hence this may reduce the incentives for countries to set up in Cyprus, putting a halt to the development of the Fintech industry in Cyprus.

#### **4. Concluding Remarks**

Cyprus has a well-deserved reputation for quality financial services. The said industry is currently undergoing rapid and far-reaching transformation, underpinned by new and emerging technologies and socio-economic drivers. This transformation is fundamentally changing market structures and opening opportunities for both incumbents & challengers to create innovative, game-changing alternative products and services. New technologies present a unique opportunity in transforming the national product where in a decentralized world, Cyprus can be one of the leading centres for innovation and growth globally, by having a strong technology infrastructure and an innovative regulatory framework.

Cyprus wishes to build upon the progress made to date in order to be on the forefront of innovation in the respective field. Through the development of DLT/blockchain technology, Cyprus aims to transform the economy, adopt new models in order to contribute to the improvement in the business environment.

The country is currently listed among the freest location for initial coin offering organizers and crypto- enthusiasts. Cypriot policy makers and government have never expressed opinions against cryptocurrencies.

In Cyprus, there are currently no specific references to cryptocurrency in the legal or regulatory framework currently in force, and cryptocurrencies are not, per se, regulated, even though, as discussed in the previous section, positive steps have been taken toward the path of establishing a comprehensive legal framework.

The success of the Fintech industry in Cyprus is strongly dependent on how strict and thorough Cyprus is on monitoring the companies. The Cypriot government should implement strict guidelines and regulations in order for companies to set up in the countries as this will help reduce the negative effects brought about as a result of the industry.

Cyprus should not only focus on the private sector blockchain, but also, they should implement the use of blockchain in the public sector in storing government files securely and safely; this will allow for a more effective and efficient government sector as a whole.

Therefore, Cyprus should maintain their 12.5% corporate tax rate whilst also providing other incentives which will facilitate investment of these firms in the country, allowing for a large number of employment opportunities, government revenue increasing and creating an image for Cyprus to become a corporate hotspot for Fintech firms, blockchain companies and financial institutions. This may be difficult due to the new discussions by the G7 countries on a minimum world corporate tax at 15% which could hinder Cyprus's chances on becoming a financial hotspot.

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