



Digital Finance Assets - Legislation, Law Enforcement Practice, Business Cases

There is increasing talk in the market of the countries of Central Asia and Caucasus about the use of digital financial assets (DFA, virtual assets) as an alternative form to raise funds. Notwithstanding the common basis and similar characteristics (use of blockchain, for example), DFA are neither a cryptocurrency nor a digital currency of the Central Banks. DFA are, first and foremost, an instrument that certifies the rights of claim to an underlying asset that

may range from cash to precious metals or real estate. The major feature of DFA is that transactions between issuers and investors are carried out without intermediaries - through the use of smart contracts, which are the digital agreements stored on the blockchain network. Both classic instruments, such as stocks and bonds, and assets that imply a customised set for a specific investor may be wrapped in digital form.

Based on the current experience of DFA using in the CIS member states, the following advantages can be identified:

- 01** ▶ Transaction speed: The issuance of DFA can take up to a month, while issuing of traditional securities can take more than six months;
- 02** ▶ Possibility to use a previously developed smart contract for subsequent transactions thus reducing the time and costs to complete for subsequent issuances;
- 03** ▶ Possibility to use DFA for futures transactions and secure future foreign trade transactions;
- 04** ▶ Possibility to issue DFA for any asset;
- 05** ▶ There are fewer intermediaries between the issuer and investor when issuing DFA compared with traditional instruments;
- 06** ▶ More favourable terms of transaction for investors: for example, gold-backed DFA are pegged to the cost of gold from the manufacturer (issuer) and do not include bank markups, and so on.

As to the countries of Central Asia and Caucasus, the DFA are not widely used there.

Armenia

Armenia, for example, currently has no law regulating virtual/digital assets. Almost 6 years ago, there was a number of initiatives in the country related to creation of a legislative landscape for cryptocurrencies and blockchain; however, these initiatives failed to gain momentum. Though the IT sector accounts for a significant share

of the GDP, and highly qualified personnel is available, tokenization has not been taken off. However, at the moment the Central Bank is actively drafting new regulatory acts but it is not yet known when these will be approved and published.

Azerbaijan

Azerbaijan is at the stage of shaping a digital agenda. Thus, in April 2023, the “Rules for transactions with virtual assets in the Republic of Azerbaijan” were approved, which are aimed at minimising the risks of using cryptocurrencies for money laundering.

However, these Rules do not regulate the concept of virtual currencies, the types of transactions with such currencies and, therefore, the terms for using DFAs backed by the underlying assets for investment purposes have not been defined.

Kyrgyzstan

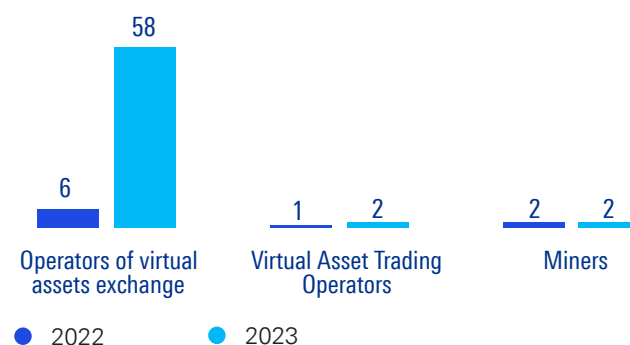
Kyrgyzstan has become one of the first countries in the Central Asia and Caucasus region to legalise the issue of virtual assets, which represent a data set in electronic digital form that has a value, is a digital representation of value and/or a means to certify property and/or non-property rights, which is created, stored and is traded using a distributed ledger technology or similar technology, and is neither a monetary unit (currency), nor a means of payment, nor a security. Thus, the law that came into effect on 28 July 2022 introduced a concept that aggregates both cryptocurrencies and digital assets functioning as a security or issued for any underlying asset. In addition, there was introduced the concept of a virtual asset service provider that can provide services in the following areas:

- Purchase and sale of virtual assets;
- Exchange of virtual assets;
- Transfer of virtual assets;
- Storage, management and control of virtual assets;
- Provision of financial services related to the initial placement or sale of the issuer’s virtual assets.

Activities of the providers are subject to licensing. In addition, there are two types of activities the suppliers are

engaged in: virtual asset exchange operators and virtual asset trading operators (crypto exchanges). According to the Service for Regulation and Supervision of the Financial Market as at 31 December 2023, totally 71 licenses had been issued.

Licenses issued to virtual asset service providers in the Republic of Kyrgyzstan in 2022 and 2023



Though the legislative framework is in place, the process of issuing tokens to raise additional funding has not been on the march.

Development of tokenization has not yet found its application in Uzbekistan. Currently, the country's legislation is aimed at regulating cryptocurrencies only.

September 2018	The concept of a crypto-exchange and licensing requirements have been defined <i>The Decree of the President of the Republic of Uzbekistan "On measures to organise operations of crypto exchanges in the Republic of Uzbekistan"</i>
December 2019	Prohibition to use cryptocurrency as a means of payment <i>The Order of the Director of the National Agency of Perspective Projects under the President of the Republic of Uzbekistan, registered on 20 December 2019, registration number 3127-3.</i>
September 2021	The Statement by the Deputy Chairman of the Central Bank of the Republic of Uzbekistan on the ban to use cryptocurrency as a means of payment
April 2022	<p>Permission for legal entities to mine cryptocurrencies (except for anonymous ones). No license is required; required is registration with the National Agency of Perspective Projects (NAPP).</p> <p>Establishment of a special regime ("Regulatory Sandbox"), and a laboratory for cryptocurrency studying/testing on the basis of NAPP.</p> <p>Introduction of permission to purchase crypto-assets for legal entities and individuals only through national providers started from 1 January 2023.</p> <p><i>The Decree of the President of the Republic of Uzbekistan, dated 27 April 2022, No. УП-121</i></p>
August 2022	<p>Completion of testing of crypto cards by Capitalbank/Ravnaq Bank and UzNEX (crypto exchange) in the regulatory sandbox and launching of issue of crypto cards.</p> <p>For example, issuing of crypto cards by Capitalbank has been launched as a result of cooperation of the following parties:</p> <ul style="list-style-type: none"> • Capitalbank (a card issuer); • UzNEX (an exchange where clients are required to register; it is also responsible for AML check); and • Mastercard (a technology partner).
September 2023	<p>NAPP has become a licensing authority for the operations of a crypto exchange, mining pool, crypto depository and crypto store, and the authority that issues the mining permits.</p> <p><i>The Decree of the President of the Republic of Uzbekistan, dated 6 September 2023, No. 3PY-866</i></p>





Since 2022, Georgia has been taking a proactive approach to development of a legislative framework to regulate virtual assets. Virtual assets refer to digital representations of value that are interchangeable and non-unique, can be transferred or traded digitally, and can be used for investment and/or payment. It does not include CBDCs, virtual currencies used as securities and other financial instruments. To be able to work with virtual assets, the entities need to register with the National Bank and obtain the status of a virtual asset service provider, unless a financial institution is authorised to provide such services under the regulatory regime. To be successfully registered the entities must comply with various requirements related to the following areas: personnel management, head office location, software, AML/CFT procedures, and others.

These are the activities that the providers can be engaged in:



exchange of a virtual asset for national or foreign currency, another virtual asset or financial instrument;



transfer of a convertible virtual asset;



virtual asset custody/administration;



management of a portfolio consisting of virtual assets;



administration of a virtual asset trading platform;



virtual asset lending;



initial coin offerings (ICOs) of convertible virtual assets and/or other ICO-related services.

However, issuance of assets is not yet widely spread.





Kazakhstan

On 6 July 2020, the law No.347-VI ZRK “On amendments and additions to certain legislative acts of the Republic of Kazakhstan on regulation of digital technologies” dated 25 June 2020 became effective in the Republic of Kazakhstan. The law includes over 200 amendments to various legislative acts designed to foster the development of digital technologies in Kazakhstan. The law introduced the definition of a digital asset, which includes the concepts of tokens and cryptocurrency, and legalised mining and blockchain technologies on the territory of the Republic of Kazakhstan.

Furthermore, amendments were made to Article 115 of the Civil Code of the RK (dated 27 December 1994, according to which digital assets are included in the list of objects of civil rights, along with other property goods and rights (property), as well as to Article 116 in terms of defining the concept and types of digital assets, and their regulation by the Kazakh legislation and regulatory acts of Astana International Financial Centre (AIFC).

The law defines two categories of digital assets:

A secured digital asset used in tokenization: a token is issued pegged to a specific asset, authenticating the rights to that asset, and exists as a “digital copy” of the underlying asset in a digital workspace.

An unsecured digital asset, which can refer to a digital medium of value that allows digital trading and operates as a medium of exchange, a unit of account, and a store of value. This may include cryptocurrencies.

It should be clarified that exchanges, where the issuance and turnover of digital assets is allowed, operate in Kazakhstan only as part of AIFC. The legal framework is based on AIFC rules, which relate to operations with digital assets and the “Rules and mechanisms of cooperation of unbacked digital asset exchanges and/or Centre participants authorised to carry out digital assets-related activities with second-tier bank of the Republic of Kazakhstan”, as well as other AIFC regulations.

The first Real World Asset tokenization project developed by crypto exchange Intebix, Mastercard and Airba Pay FinTech based on smart contracts and blockchain was unveiled at the Digital Bridge 2023 on 12-13 October 2023. The project will enable users to convert their cryptocurrency into Technodom Plus bonuses on the Intebix with the subsequent purchase of goods or services in the Technodom trading network, which means that the token signifies ownership of the real world asset.





So how has the DFA regulation evolved in the world?

Among European countries, Switzerland leads the development of the DFA concept. Globally, blockchain and cryptocurrency legislation has been shaped over the past 10 years. As for DFA, the Financial Market Supervisory Authority (FINMA) issued guidelines in 2018 that categorised tokens, among which the so-called asset tokens are defined. The guidelines state that asset tokens provide a right of claim against an issuer or a right to participate in the entity's equity, which is consistent with the way stocks, bonds, and derivatives operate. This category also includes tokens that represent physical assets. FINMA recognises such tokens (asset tokens) as a type of securities and, accordingly, they are subject to Swiss securities legislation.

In September 2020, Switzerland enacted a law adapting federal legislation to the development of distributed ledger technology. The amendments introduced the category of securities to be registered in an electronic register and the trading systems used for such securities. The law introduced new asset class as a digital equivalent of securities with rights pegged to a token stored in a distributed ledger. However, the law does not impose specific technical requirements on the distributed ledger that issues such rights.

One of the first companies to issue its tokenized shares was Mt Pelerin Group SA1.

In 2021, SEBA, the Swiss bank, issued a token backed by extracted gold, in cooperation with Argor-Heraeus and aXedras. This initiative was aimed at shaping cost-effective ways to access precious metals for the development of the Swiss gold ecosystem. Unlike traditional investment instruments, DFAs backed by gold enable investors to buy back physical gold at any time at no cost for storage and transportation.

In 2019, approximately CHF 3 million was raised through the issuance of tokens backed by a real estate item in the city of Baar. Eighteen apartments and a restaurant were sold to four investors.

In the CIS market, Russia leads the way in terms of development of the DFA legislative framework and environment. The main regulatory framework shaping the legislative landscape is represented by three major acts of law.

- Federal law No.259-FZ "On digital financial assets, digital currency and on amendments to certain legislative acts of the Russian Federation" dated 31 July 2020;
- Federal law No.331-FA amending the Federal Law "On banks and banking activities" and prohibiting the use of DFA as a means of payment" dated 14 July 2022;
- Federal law No.45-FZ dated 11 March 2024 amending the following regulatory acts:
 - Federal law No.115-FZ "On combating legalisation (laundering) of proceeds of crime and terrorism financing" dated 7 August 2001;
 - Federal law No.149-FZ "On information, information technologies and information protection" dated 27 July 2006;
 - Federal law No.173-FZ "On currency regulation and currency control" dated 10 December 2003;
 - Federal law No.259-FZ3 "On attracting investments using investment platforms" dated 2 August 2019;
 - Federal law No.211-FZ "On performing financial transactions using a financial platform" dated 20 July 2020;
 - Federal law No.259-FZ "On digital financial assets" dated 31 July 2020.

This law was a first step to allow digital financial assets to be used in international settlements – as a consideration under foreign trade agreements made between residents of the RF and their counterparties. Generally, DFA will continue to serve a function as rights of claims, and therefore, they will not be a pure instrument of payment under the contracts.

As for the development of the DFA market, the first DFA issuance took place only a year after the Federal Law No.259 came into force, in summer of 2022. The law became a first statutory instrument to define a concept of "a digital financial asset", regulate a DFA issuance procedure, license the activities of the operators of information systems and platforms to enable the exchange of DFA.

Among the first companies licenced to operate as an information system operator (ISO) were Lighthouse, Sberbank, and Atomize. Currently, there are 10 operators in Russia.

	2022	2023
Number of ISOs	3	10
Number of DFA issues	19	323
Outstanding DFAs, million RUB	728	60,000

A year and a half later, the number of transactions increased significantly. Basically, an 80-fold increase in the volume of DFA issues was noted as at 13 December 2023, compared to 31 December 2022. Moreover, the numbers of issuers and instruments grew substantially: a 17-fold increase in the number of issues, and an 8.5-fold increase in the number of issuers (from 10 to 85 companies).

In 2023, the company A-Token (Alfa Bank) became a leader in issuing DFAs, accounting for 32.7 billion roubles of the total assets issued. It is noteworthy that in the first quarter of 2024 (as at 25 March 2024) DFA issues of more than 15 companies were placed. Thus, one of the largest DFA issues for institutional investors has been held together with Rosatom. The issuer was Atomenergoprom JSC (a subsidiary of ROSATOM), the world's largest company engaged in construction of nuclear power plants. One hundred DFAs worth a total of 10 billion roubles were issued as cash claims, with a rate of return of 7.35% p.a. and maturity in 90 days. It should be noted also that connecting to the platform took only four days, which makes this tool much more convenient compared to the process of issuing conventional financial instruments, which can take several months.

Atomyze blockchain platform ran the issues for 25 issuers, of which seven issues have been held in 2024. Thus, in March 2024, DFAs issued by GPF Investments, a subsidiary of Nornickel, were launched on the platform. This is the company's first token release pegged to a basket of five precious and non-ferrous metals – gold, platinum, palladium, nickel, and copper. Tokens are priced automatically according to the prices for underlying assets quoted during evening trading sessions at the London

Metal Exchange (LME) and the London Bullion Market Association (LBMA). The total issue amounted to 1,000 tokens, worth 11 million roubles, with a 1-year maturity. These DFAs are accessible exclusively to qualified investors, clients of the Rosbank L'Hermitage Private Banking.

Although the DFA sector has just been operating for a short time in the Russian Federation, market experts are very optimistic about the prospects of DFA segment, expecting the number of transactions to grow. According to the Expert RA agency's research, the DFA market volume may reach 125 billion roubles, while according to the Moscow Exchange – as much as 300 billion roubles.

The second country, which is actively engaged in tokenizing real-world assets, is the Republic of Belarus. The country has established a special legal framework whereby the term "a digital financial asset" means a token or a digital item, which contains a digital code (a "digital shell") in which information about an issuer, rights, obligations, and the owner is recorded. Generally, tokens can be represented by monetary claims, issuance securities, ownership interests in the capital of a company, and claims for transfer of issuance securities.

Initially, a "digital unit" was defined in the Decree of the President of the Republic of Belarus No.8 "On the Development of Digital Economy" dated 21 December 2017, which jump-started the tokenization in the country. Next year, the Law of the Republic of Belarus No.135-3 "On amendments and additions to certain legislative acts of the Republic of Belarus" dated 17 July 2018 was adopted.

Basically, the term "token" refers to a record in a transaction block registry (blockchain), or in another distributed information system that certifies the rights of the token holder to the objects of civil rights, and/or is a cryptocurrency.

It should be mentioned that the digital units are issued in the country in the territory of High-Tech Park (HTP). The HTP Supervisory Board has drafted and adopted legislation to regulate the activities of cryptocurrency companies, including those providing token creation and placement services. To protect the rights of investors (or customers) of the organisation, the regulatory acts set requirements, in particular, for the capital, key management, business reputation, IT systems, and White Paper requirements, which are subject to annual review by the specified audit firms.

Currently, five companies have been registered in HTP, which are engaged in the ICO (Initial Coin Offering) activities, including Dzengi, Dzengi Com, DFS, ERPBEL, and Pixel Internet.

DFS is the best known among them; it is engaged in issuing DFAs on the Finstore crypto platform. The funds raised by the company from 2019 to 2023 totalled 142 million US dollars. The remarkable fact is that the year 2023 alone accounted for 64 million US dollars in funding.

In December 2023, the Russian company Atalaya launched its first DFA issue on the DFS's platform. The issue was worth 40 million US dollars, with the DFA yield being pegged to the US currency and set at 7.5%. The DFA term is three years.

In 2023, the USD-denominated tokens of Belarusian Railway, the national state-owned railway company of Belarus (a leader of the national transportation system), were also issued on the Finstore crypto platform. The

issue was worth 5 million US dollars; tokens bear an interest rate 7.9% p.a. and mature in 37 months.

In the same year, the company ACTIVISING LLC launched on the platform the second and third issues of DFAs, denominated in US dollars and euros; tokens bear an interest rate of 8% p.a. and mature in 2 years. The issue was worth 300,000 US dollars and 200,000 euro, respectively.

The specific feature of development of tokenization in Belarus is that the issuers have not extended beyond the so-called quasi-bonds, and digital units developed for real assets have not yet found a place in the market and have not been underpinned by the related regulatory component.

According to many experts, the DFA (virtual assets) market will be growing rapidly. Thus, in the view of KPMG, asset tokenization may see a 28-80-fold growth, depending on scenarios, in the next few years.



Contact



Farrukh Abdullakhanov

**Partner, Head of consulting,
KPMG Uzbekistan**

E: fabdullakhanov@kpmg.com



Margarita Starostina

**Consulting Services Manager,
KPMG Uzbekistan**

E: margaritastarostina@kpmg.co.uz

kpmg.uz

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2024 "KPMG Valuation and Consulting" LLC, a company incorporated under the Laws of the Republic of Uzbekistan and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.