

## REGULATION OF CRYPTOCURRENCY TRADING

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**Abstract:** The origin, the forms of existence and the legal regulation of money intrigue representatives of all economic schools, as well as lawyers from different legal systems. They look for answers to the questions about the essence of money, about its future and about the degree of alternative payment means and systems. Their evolution follows the level of development of the society itself in order to meet its requirements and needs. The purpose of this research is to propose an approach to the institutionalization of virtual currencies in Bulgarian legislation and the regulation of cryptocurrency trading. The process of establishing the European Union as a common framework for integration between member states once again brings to the fore the question of the economic freedom of citizens. The development of a single common market is based on four "pillars" - the "four freedoms" - freedom of movement of goods, people, services and capital. This, in turn, is a prerequisite for the entry of modern societies into the new "axial time" - the time of globalization. And it, in turn, determines the new challenge for the financial, economic and legal thinkers of the XXI-st century - to institutionalize the practical characteristics of its manifestations. One of these manifestations is the existence of a digital society, in which the relevant financial relations have a digital form and a digital essence. The regulation of cryptocurrencies is a hot topic these days, as they have become increasingly popular among investors and users in recent years. The report analyzes the risks in financial services with cryptocurrencies. The essence and specifics of the relatively new sector of the global financial market, namely cryptocurrency trading, are the basis for understanding the peculiarities and difficulties in the introduction and implementation of regulatory measures for trading in so-called alternative financial instruments. The stable functioning of the financial markets as a whole and the stimulation of their healthy growth are closely linked to the level of consumer confidence, which in turn is determined by the level of consumer protection as citizens of the European Union. The European Union's regulatory framework for crypto-assets, known as MiCA (Markets in Crypto-Assets Regulation), is the subject of much discussion in the crypto industry. MiCA aims to create a harmonized regulatory framework for crypto-assets in the EU and provide investor protection measures. The main challenges of MiCA include assessing its applicability to all types of cryptoassets currently operating in the market, as well as possible new types of cryptoassets that may emerge in the future.

**Keywords:** cryptocurrency, financial services, EU law

### 1. INTRODUCTION

Investigating the regulation of cryptocurrency trading is a spin of the “wheel of fortune”. Making sense of previous financial practices, economic relations and politically acceptable models precedes making sense of their significance for the development of society. Human society will never feel free enough, it will never stop looking for new dimensions and manifestations of individual freedom, it will never stop looking for the intersection of common interests.

The development of a single common market is based on four "pillars" - the "four freedoms" - freedom of movement of goods, people, services and capital. This, in turn, is a prerequisite for the entry of modern societies into the new "axial time" - the time of globalization. And it, in turn, determines the new challenge for the financial, economic and legal thinkers of the 21st century - to institutionalize the practical characteristics of its manifestations. One of these manifestations is the existence of a digital society, in which the relevant financial relations have a digital form and a digital being. An essential example of such a manifestation is the regulation of cryptocurrency trading, which has its successive stages – measuring the concept of cryptocurrency, measuring the legal consequences in different types of legal relations, and most importantly regulating cryptocurrency trading.

The global cyberspace in which crypto-assets, including cryptocurrencies, are exchanged can be explored through the prism of the famous message of the famous English writer John Fowles - "we want to create worlds as real as the world that exists, but different from it".

In view of the objectives of the present study, virtual legal reality is of interest. The study of virtual reality as a legal reality began at the beginning of the new millennium with the development of digital technologies. Vihar Kiskinov is the first Bulgarian scientist who examines the virtual legal reality by outlining the characteristics of the concept and tracing the main meanings embedded in it. He reveals that the differences between virtual reality and virtual legal reality are solely about the legal action and legal qualities of the virtual environment, which in turn are

determined by the normative acts. Vihar Kiskinov defines the virtual legal reality as "another environment, along with our familiar public environment of the pre-information society, in which complete processes of legal action take place".

The virtual legal reality consists of "phenomena, states and special legal mechanisms through which the legal system exists and operates in the virtual environment. In an instrumental aspect, the virtual legal reality unites interacting information systems and technologies, databases, means of exchange and authentication of electronic messages, identification technologies. Vihar Kiskinov defines virtual reality as a non-physical reality created through information and communication technologies. It is relatively independent of material reality because it has immaterial foundations; virtual reality arises when the relations developing in it are subject to legal regulation.

## **2. BULGARIAN REGULATORY FRAMEWORK OF FINANCIAL TRANSACTIONS WITH CRYPTOCURRENCIES**

In the modern digital society, we seek an electronic form to every legal fact or event. Inevitably, this happens with money, too. Fiat money no longer a self-sufficient instrument of exchange or savings. We seek to recognize in monies qualities such as anonymity, maximum speed of exchange, and their transformation into a universal trading tool that is not controlled by an institution such as the Central Bank. In 2007, the idea for the most widespread electronic currency to date "Bitcoin" was publically announced. The name bitcoin comes from the English language and literally contains two logical constructions - bit, which means a unit of information, and coin, which means a coin. The author of the concept behind Bitcoin is a person behind the pseudonym Satoshi Nakamoto, who developed it in the period 2007-2008, when he first published his article about Bitcoin, as a result of which on 02.04.2009 Bitcoin is already a real existing product. It is defined as a decentralized virtual currency that is not managed like typical currencies by a specialized institution and can be seen as a digital code that meets certain conditions completely subject to the rules of mathematics.

With the development of blockchain technology, the virtual environment in which Bitcoin is used also grows. There is an objective need to give a legal definition of virtual currency. It is contained in the Law on measures against money laundering, adopted in 2018. In item 24 of § 1 of the additional provisions of the law, virtual currencies are defined as "a digital representation of value that is not issued or guaranteed by a central bank or by a public authority, is not necessarily related to a legally established currency and does not have the legal status of a currency or of money, but is accepted by individuals or legal entities as a medium of exchange and can be transferred, stored and traded electronically."

The concept of cryptocurrency does not have a legal definition in Bulgarian legislation, yet, but is used in various acts of state authorities. The Council of Ministers with its Decision No. 672 of 17/09/2021, approving an Action Plan to limit the risks of money laundering and terrorist financing pays special attention to financial services with cryptocurrencies. According to this decision, cryptocurrency service providers are planned to establish a legal framework that requires them to have a physical presence in the EU and will be subject to prior authorization by a national competent authority before they can start their activities. They will be subject to capital requirements, governance standards and an obligation to segregate their clients' assets from their own assets. These cryptocurrency service providers will also be subject to information requirements to avoid the risks of cyber theft and hacking. The new rules will also prohibit the abuse of secondary cryptocurrency markets that were not previously covered by the Financial Services Regulation.

Regarding cryptocurrencies, there are various legal rulings regarding tax relations. The Personal Income Tax Act regulates the taxation of personal income from the purchase and sale of cryptocurrencies. These incomes are treated for tax purposes as income from foreign currency transactions. The taxable income from the sale or exchange of shares, shares, compensatory instruments, investment bonds and other financial assets, as well as from foreign currency trading, is the sum of the profits realized during the year, determined for each transaction, reduced by the sum of the losses realized during the year, determined for each individual transaction. There are different features when declaring received cryptocurrencies in the form of cash back (return of a percentage of a purchase made with fiat money with a debit card and refund of part of the same amount in cryptocurrency) and cash rebate (purchase or subscription to a service in fiat money through debit card, the value of which at market prices is restored to the wallet in cryptocurrency).

In a letter from Bulgarian National Bank with outgoing number - 108809 dated 19.09.2014 to the Deputy Director of the Bulgarian National Bank, sent on the occasion of an opinion requested by the Sofia City Court, it is stated that the virtual "Bitcoin" is not a legal means of payment. The activities of acquiring, trading and paying with "Bitcoin" are not regulated by the current national and European legislation and are not subject to licensing or registration. The purchase and sale of virtual currencies and payments with them, including "Bitcoin", do not fall within the scope of Directive 2009/110/EC of the European Parliament and of the Council of 16.09.2009 on the undertaking, exercise

and prudential supervision of the activity of electronic money institutions and Directive 2007/64/EC subsequently replaced by Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, respectively within the scope of the Payment Services Act and the payment systems in which the mentioned European acts are transposed into the Bulgarian legislation. The provisions of these acts are not applicable to the purchase and sale of "Bitcoin" and the execution of payment operations with "Bitcoin" and other similar virtual currencies.

Operations through which payments are made using "Bitcoin" or other similar virtual currencies on the territory of the country do not fall within the scope of the Law on the Restriction of Cash Payments, as they cannot be qualified as "cash payments" within the meaning of the same law. It is necessary to explicitly note that all payments in Bulgarian leva or foreign currency on the territory of the country, made in cash, which are related to transactions or performances for the purchase and sale of "Bitcoin" or other similar virtual currencies, fall within the scope of the restrictions on cash payments regulated in the Bulgarian cash payment limitation act.

### **3. CRYPTOCURRENCIES EU REGULATORY FRAMEWORK (MiCA)**

The European Parliament defines in Markets in Crypto-assets Regulation the importance that the Union ensures legislative acts on financial services are fit for the digital age, and contribute to a future-proof economy that works for people, including by enabling the use of innovative technologies. The Union expectation is that many applications of distributed ledger technology, including blockchain technology will continue to result in new types of business activity and business models that, together with the crypto-asset sector itself, will lead to economic growth and new employment opportunities for Union citizens.

In May 2023, the Council of the European Union approved a bill to regulate the crypto-asset market (MiCA), thereby simplifying the authorization process for cryptocurrency service providers. The Regulation on markets in crypto-assets (MiCA) was published in the Official Journal of the EU on 9 June 2023 and entered into force on 29 June 2023. In its essence the MiCA legal framework in force gives definitions and guidelines, nevertheless the full MiCA regulation is scheduled to be introduced and come into force by end of the year 2024. By June 2024, the European Securities and Markets Authority (ESMA), in collaboration with the European Banking Authority (EBA), is expected to have prepared draft Delegated Acts of MiCA. Core chapters of MiCA covering asset-referenced and e-money tokens regulation are set to come into force by June. By the close of 2024, all components of the MiCA regulation should be actively governing crypto-business operations within the EU and in its entirety in force.

MiCA provides crypto companies within and outside of the EU with the opportunity to conduct business in all EU member countries with a single license. Each EU-member country is tasked to develop detailed guidelines for implementing the new legislation.

Markets in Crypto-Assets Regulation legal essence is a draft legislation that aims to create a comprehensive legal framework for the regulation of crypto assets in the EU member countries. The core objective of the crypto-assets regulation is to replace individual national laws found within multiple EU nations with one universal and comprehensive legal framework applicable to all EU country members. Additional objectives of MiCA are to set universal clear rules for crypto-asset service providers and token issuers and to provide more certainty in the regulation of crypto assets where currently it is not covered by the financial regulations in place.

In July 2023 the European Securities and Markets Authority (ESMA) published a 160-page document explaining MiCA. Core obligations governed in MiCA for crypto-currency entities include that applicants for obtaining a license in the EU must prove that funds from clients and the company are separated, as well as describe in detail the security measures of the system. Additionally, crypto businesses have a responsibility to identify and manage potential conflicts of interest. There are multiple companies based within EU already applied for a crypto-asset licence and got approved proving that the MiCA aim to ensure business entities in the crypto industry comply to EU standards of customer protection and anti-money laundering procedure and financial assets management regulation showcases its results of ensuring compliance and protection of the economic cycle within the Union. Examples of companies that are utilizing MiCA Regulation are USDC co-issuer Circle which has filed for registration in France, and conglomerate Societe Generale that has already received a digital asset service provider license through its subsidiary Forge.

MiCA legal framework defines conditional terms to apply for a crypto-asset company license. To open a crypto-processing service, companies shall fulfil a number of conditions such as have an authorized capital of €120,000, open an account with a licensed financial company for working with fiat money, implementing anti-money laundering (AML), continuity of services, and data security policies and procedures, etc.

Banks will begin working with cryptocurrency companies in 2024 after MiCA comes in its entirety into force. This will make the crypto-assets more accessible to consumers and raise the market share of crypto-assets spread across

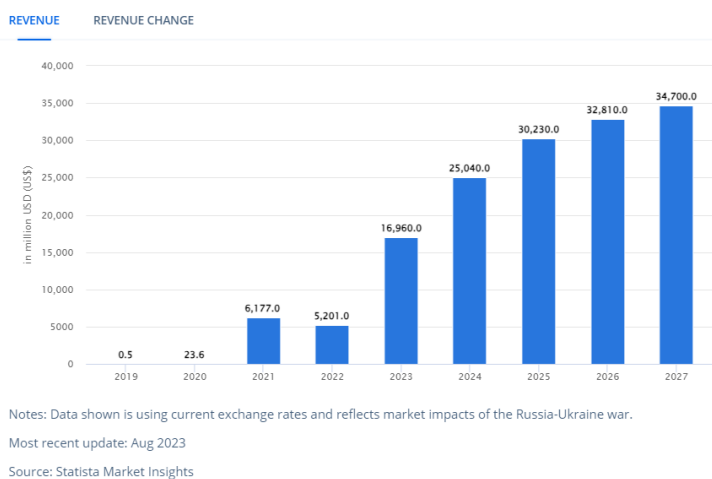
the EU, including Bulgaria. The Bulgarian legislation initiative on implementing national regulation and guidelines on MiCA enforcement has gaps.

#### 4. RISKS IN FINANCIAL TRANSACTIONS WITH CRYPTOCURRENCIES

The risks in transacting with cryptocurrencies are many, the main one being the lack of universal regulation of the industry parties whether it is the companies selling the crypto-asset, the buyer who most of the time is in the capacity of a consumer, the companies processing the monetary exchange for the sell-purchase of the crypto-asset, etc. Having MiCA regulation mitigates the risks to previously non-regulated crypto-assets sector, nevertheless we shall establish that any crypto-currencies entities which are outside of the EU and or do not hold a valid licence within the EU are outside of the scope of MiCA and EU citizens shall be aware of the risk of non-compliance and difficulty in obtaining protection, for example the benefits of protection of the rights available to consumers for regulated financial services, such as complaints or recourse mechanisms will not be available.

Subject to significant fraud and money-laundering risks lie in areas of crypto industry that are outside of the defined in MiCA assets, tokens issuance, and service providers regulations. Despite the legislator's aim to cover the entire crypto market, some specific sectors of the crypto market are purposefully not included in the MiCA regulation. Non-fungible tokens (NFTs) that are publicly available at a fixed price, such as digital collectibles such as paintings, logos, photos or items in computer games, are not included in MiCA's definitions. But depending on their behaviour in the market and how projects built around non-fungible tokens develop, the rules allow for the possibility that a project could be reclassified in the future as a financial instrument or crypto-asset, in which case the MiCA rules would still apply.

Another sector of the crypto industry that remains outside the regulations is decentralized finance (DeFi), which was excluded from the final version of the document last minute. Instead, the EU Parliament decided that 36 months after the date of entry into force of MiCA, the European Parliament and the Council will consider a detailed report assessing the extent of the threat from money laundering, terrorist financing and other criminal activity that might be abused by decentralized crypto exchanges. Depending on the results presented in the report, the European Union will develop additional measures for decentralized financing. The world's decentralized crypto-assets market volume has grown significantly in the past year from a market volume of 5 billion USD in 2022 to close to 17 billion USD in 2023. Statistic projections foresee increase in DeFi sector by more than 25% year to year until 2025. Based on the DeFi sector growth in the crypto-assets market, earlier or later the regulators must include it in the MiCA scope of compliance and protection .



The last risk factor to be reviewed in this work is the anti-money laundering (AML) compliance and terrorist financing in the cryptocurrency industry. As the essence of the cryptocurrencies it for them to be with anonymous nature and decentralized, often the same are recognized as a high risk asset for financial crimes, including money laundering and terrorist financing. Procedures on AML compliance function by integrating an anti-money laundering procedures within the operations of crypto-related businesses. These procedures include customer due diligence also known as know your customer procedure (KYC), transaction monitoring, and suspicious activity reporting and reporting of any suspicious activity to competent authorities. The aim is to recognise and assess eventual risks, monitor customer transactions for any suspicious activity, and report any findings to the relevant authorities.

## 5. CONCLUSIONS

One of the main philosophical principles is the principle of non-contradiction. Its initial form - "don't contradict yourself because you can't think" developed into the maxim "create the rules of your activity yourself." Order is defined as the arrangement of elements relative to one another according to a certain sequence, pattern, or method. Order in a social system is a guarantee for its functioning and for its continued existence. The imperative of the administrative order is a feature of the state as a political organization.

MiCA is the beginning of crypto legislation. The first step towards general regulation of cryptocurrencies. With the development of this type of trade, the original regulations will be further developed. Clarifications and guidance will be provided. There are nearly 2 billion potential consumers in the world who do not have access to banking services. Cryptocurrencies could allow each of them to participate in global financial life relative to future regulations.

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