
CLIENT NOTE

THE CURRENCY OF THE FUTURE: DIGITAL ASSETS



INTRODUCTION

Nowadays, living in a digital world, means digital assets are everywhere around us. From movie streaming on Netflix to sharing a picture on WhatsApp or even storing work-related documents on the cloud, whether we like it, or not digital assets are part of our everyday life. However, we wonder how digital assets are legally and regulatorily implicated. Despite the increased use of digital assets, there's still a disconnection between what's considered a digital asset.

Imagine a world where everything is paper-based, and digitalization does not exist. Where you have to store relevant documents on shelves and have a hard time to find them on time. This is what was in place before the “digital asset management system” was established in the beginning of 1990’s.

WHAT ARE DIGITAL ASSETS?

“Digital assets are files created electronically, and that exist as data held on a digital storage drive or computer system. However, items made by hand can become a digital asset; a painting or handwritten notes become digital assets if they are scanned and uploaded to a computer”¹. Besides, the above-mentioned items, a digital

¹<https://openasset.com/blog/what-are-digital-assets/#:~:text=Digital%20assets%20are%20files%20created,and%20uploaded%20to%20a%20computer>

asset can be “any digital material owned by an enterprise or individual including text, graphics, audio, video and animations”². The list is not exhaustive. Indeed, some other sources consider data packages, user data, user accounts cryptocurrency tokens as digital assets.



Unlike physical assets, digital assets do not exist in a physical form. As a matter of fact, bitcoins are considered digital assets, because they constitute an electronic record, created and stored exclusively on the Bitcoin chain. Its ownership is represented in an electronic record. For example, an electronic record of the ownership of real estate is stored on a digital ledger. It may include an electronic record that contains all the rights associated with ownership, although the asset itself – the real estate – exists apart from the electronic record. The electronic ledger could not necessarily be a blockchain. However, assets contained on a blockchain are commonly referred as “blockchain tokens”. A blockchain token is “a digital token created on a blockchain as part of a decentralized software protocol”.

CRYPTO ASSETS

Crypto-assets are generally held as investments by people who expect their value to rise and “are broadly defined as private digital assets that use cryptography and are designed to work as a medium of exchange”³. Besides, it is a digital data unit that has no formal issuer and thus is exclusively issued and transferred via open, permission-less DLT systems.

Cryptocurrencies are the most known crypto-assets and are used as a of exchange on exchanges and trading platforms. For instance, Bitcoin, Ripple, Litecoin, and Ethereum are the most known types of cryptocurrencies.

Nowadays, crypto assets are considered as a highly volatile medium exchange, as no proper regulation exists giving them legal certainty and sustainability. Moreover, unlike cash, cryptocurrencies exist electronically and use a peer-to-peer system, which is not managed by governments or central banks. This makes them desirable because investors think of having more control over their funds. Nevertheless, without banks controlling the assets, this system may create a higher risk of fraud or theft, in which case refund of stolen assets becomes highly unlikely.

DIGITAL FINANCIAL ASSET REGULATION IN THE REPUBLIC OF ARMENIA

Armenia does not have a regulatory/legal framework regarding digital financial assets/cryptocurrencies. The Central Bank of the country (as many other central banks) so far has been unwelcoming to their use, though many individuals and businesses own such assets. Based upon a recommendation of the Central Bank, Armenian banks and other financial institutions shy away from serving their customers in regard to transactions with digital financial assets. Though it is unclear whether this will change in the future, yet we believe that regulators around the world will find ways to live with digital financial assets.

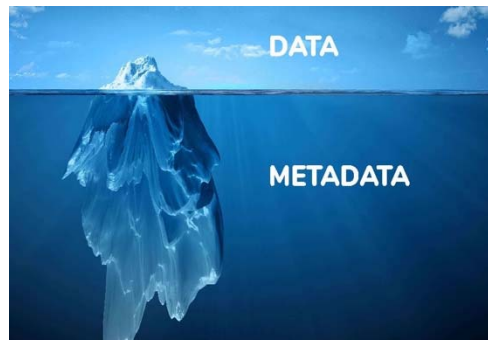
DOWNSIDES OF DIGITAL TRANSACTIONS

² <https://www.mediaalet.com/blog/what-are-digital-assets/>

³ <https://www.lawsociety.ie/gazette/in-depth/crypto-assets/#:~:text=Crypto%2Dassets%20are%20broadly%20defined,an%20alternative%20to%20fiat%20money.>

The main challenges and concerns in the use of digital assets are the following;

- (i) **Storage.** The digital payload can be quite large, and even a relatively small number of digital data may require more space than traditional business storage solutions can offer.
- (ii) **Security.** Cyber security is a growing concern as malware, ransomware, and hackers become increasingly prevalent and unpredictable.
- (iii) **Consistency.** Due to multiple digital assets, the process of updating, tracking, and sharing the most recent versions of files is fraught with difficulty. Huge efforts must be carried out to avoid any error.
- (iv) **Access.** it is difficult to safeguard more sensitive documents and restrict access or the timing of access so that only authorized users can view and retrieve certain files.
- (v) **Liability and Rights.** Digital transactions can often be part of money laundering and terrorist financing schemes, as they enable the execution of anonymous and cross-border transactions. Moreover, there are no legal mechanisms ensuring the legal protection of legitimate interests of customers, as well as the possibility of compensation for the damages incurred by the customers is not specified. Apart from that, there is also a huge risk of avoiding the inadvertent use of assets that are copyrighted or belong to other organizations.
- (vi) **Implementation Costs.** The costs associated with storing, securing, and maintaining the digital assets might be cumbersome, especially for small corporations.
- (vii) **Ownership and Possession.** The general approach regarding the ownership rights towards digital assets is uncertain. Some legal systems (like Japan and German laws) set out that digital assets have limited property rights but are not entitled to ownership. Whereas others state that digital assets be the object of the right of ownership and thus recognize the property rights of digital assets.



DIGITAL ASSET MANAGEMENT- METADATA

As a response to overcome the aforesaid challenges, the digital world has created Digital Asset Management (DAM) system, which constitutes a cloud storage system that stores, shares and organizes digital assets in a central location. DAM system increases the security, organization and searchability of digital assets. To make a DAM system more effective, metadata, which is constituted from keywords and essential descriptive information used to track and store digital assets.

CONCLUSION

To conclude, digital assets have their advantages and disadvantages, depending on the type of asset it is. Stocking work files or personal items such as photos and videos on a cloud system makes it much easier to locate them and thus saves a lot more time. Yet, financial assets, such as cryptocurrencies and tokens do not come without risks, hence the need of weighing the pros and cons before making any significant investment.

HOW WE CAN HELP?

Our firm has extensive experience in how to adopt and implement sufficient and effective strategies to deal with digital assets, as well as providing recommendations in relation to necessary procedures and policies ensuring the storing, securing, and maintenance of digital assets.

NOTE: This material is for general information only and is not intended to provide legal advice

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