JURISDICTIONAL ARBITRAGE: COMBATTING AN INEVITABLE BY-PRODUCT OF CRYPTOASSET REGULATION

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Abstract

Purpose- This paper aims to provide an overview of different issues related to jurisdictional arbitrage found in general regulatory arbitrage literature and their projection to the specific area of cryptoasset regulation.

Design/Methodology/Approach- By distinguishing any parallel, analogous and neighbouring concepts, this paper attempts to clarify the notion of jurisdictional arbitrage. By discussing certain aspects and effects of three regulatory regimes, BitLicense, 5th Anti-Money Laundering Directive (AMLD5), and the European Commission's Proposal for a Regulation on Markets in Crypto-assets (MiCa), it makes clear that national/State/regional policymakers have already failed to create arbitrage-proof regulatory frameworks by acting exclusively within the limits of their jurisdictions. Against this background, this paper discusses briefly regulatory competition and international harmonisation as alternative solutions to inappropriate and ineffective national/regional legislative approaches.

Findings- Based on a structured theoretical analysis, this paper reaches three important findings: first, academics, international bodies, and other commentators employ inaccurately the general concept of 'regulatory arbitrage' in order to refer to the specific problem of jurisdictional arbitrage creating in this way an interpretative confusion; second, commentators confuse jurisdictional conflicts with jurisdictional arbitrage; and third, the solutions to this regulatory problem can actually be found in its underlying causes.

Originality- To the best of the author's knowledge, this is the first specific-issue paper on jurisdictional arbitrage in the context of cryptoasset regulation and aims to trigger further academic discussion on this evolving phenomenon and inform the development of future cryptoasset regulation combatting this problem.

This is a peer reviewed, accepted author manuscript of the following research article: Draganidis, S. (2022). Jurisdictional arbitrage: combatting an inevitable by-product of cryptoasset regulation. Journal of Financial Regulation and Compliance. https://doi.org/10.1108/JFRC-02-2022-0013

Keywords Regulatory arbitrage, cryptoasset regulation, regulatory competition, international harmonisation, regulatory regimes.

Article classification Literature Review

1. Introduction

Since the advent of the archetype cryptoasset, Bitcoin, in 2009, there have been many developments in the related technological, financial and legal/regulatory areas. A plethora of new cryptocurrencies, exceeding 7.580 in number (https://coinmarketcap.com, 2021), and other types of cryptoassets have emerged, changing the applicable regulatory nomenclature from the narrow market-based term of 'Bitcoin'[1] to broader terms, such as 'virtual currencies'[2] or 'cryptoassets'[3] (Blandin *et al.*, 2019). New market practices, such as Initial Coin Offerings, have been introduced and employed successfully to raise capital for the crypto-industry and the crypto-market itself has created new intermediaries as an integral part of its ecosystem in order to facilitate transactions. Finally, there have been new challenges to be addressed by policymakers and regulators.

These challenges involve any possible ways of regulating the relatively new financial and technological cryptoasset phenomenon. Indeed, this question of how to regulate cryptoassets has been a pressing problem worldwide. Gradually, a swift towards some form of regulation of this phenomenon, with a number of national, and more recently, regional policymakers taking the lead, has been observed. In 2014, Canada became the first country in the world to enact specific domestic law on digital currencies and bring related financial transactions within the ambit of national anti-money laundering/ combatting the financing of terrorism (AML/CFT) law (Duhaime, 2014). Shortly afterwards, BitLicense was adopted by the New York State in 2015, paving the way globally, as the first comprehensive regulatory attempt on US Federal (Callen-Naviglia and James, 2018) but also international level (Syska, 2017), to regulate crypto-businesses. Though this scheme contains certain provisions related to AML/CTF and financial stability imposing, respectively, an obligation of adopting a robust anti-money laundering (AML) Program and capital requirements, it clearly focuses on consumer protection by introducing certain disclosure and other protection requirements (See Official Compilation of Codes, Rules and Regulations of the State of New York, 2020), disregarding, according to some market participants, other important aspects such as technological development and innovation (Syska, 2017). Since these early regulatory developments, some jurisdictions around the world have prohibited cryptoactivities, others have provided some kind of regulatory guidance, others have adopted bespoke regulatory frameworks, others have extended or amended their current financial legislation to fill the emerging regulatory gap and cover explicitly cryptoassets or, simply, they have done nothing (Cuervo *et al.*, 2019; Blandin *et al.*, 2019).

Unfortunately, alongside the occurrence of such diverse national regulatory treatment and the subsequent creation of a globally fragmented regulatory landscape, jurisdictional arbitrage, a phenomenon familiar to legal academics, policymakers and regulators, has found fertile ground to flourish. This regulatory phenomenon is actually a category of the general phenomenon of 'regulatory arbitrage'. The latter has been treated, generally, by scholars as having mainly a negative sense (See, e.g., Willesson, 2017; Langenbucher, 2019; Langenbucher, 2021), meaning, in essence, that it "implies an avoidance strategy" (Willesson, 2017, p. 77). As such, it may be seen as a 'problem' attached to any adopted or, even, proposed piece of national/regional legislation concerning transnational issues. It is further perceived as being closely interrelated to other negative regulatory concepts, such as the co-called 'race to the bottom'. For instance, Frantz and Instefjord (2018, p. 819) note that "regulatory competition leads to a race-to-the bottom effect *because of the threat of regulatory arbitrage* [my emphasis added]". Apart from academic attention drawn to this 'danger' in general, the same issue has been acknowledged and addressed by policymakers and regulators across the globe, specifically in the field of cryptoasset regulation. One of the most recent regulatory developments in the field has been European Commission's MiCa aiming, *inter alia*, to apply uniform rules across the EU and minimise regulatory arbitrage in that particular area (European Commission, 2020b).

The so-called 'danger' of regulatory arbitrage has not been left unnoticed by FinTech journalists (See, e.g., Poster, 2019) but despite its explicit importance for both theory and practice, there is limited academic literature, generally, on regulatory arbitrage (Willeson, 2017) and particularly, due to the subject's novelty, on jurisdictional arbitrage relating to cryptoassets. This article aims to fill this gap by exploring, from a legal perspective, the concept and taxonomy of regulatory arbitrage, focusing on jurisdictional arbitrage in the context of cryptoasset regulation, its cause(s), ways of occurrence in practice and consequences and suggesting two alternative solutions to this problem. Jurisdictional arbitrage, a market participants' strategy, should not be confused with jurisdictional conflicts. Although this piece of work touches lightly upon 'forum shopping' and mentions a 'conflict of laws' solution, it does not cover conflict of laws aspects of cryptoassets, e.g., issues about jurisdiction or applicable law.[4]

2. Defining and clarifying 'jurisdictional arbitrage'

Although there are various definitions of 'regulatory arbitrage' found in academic literature (Willesson, 2017; Pollman, 2019; Langenbucher, 2021) and non-academic sources,[5] it would be helpful to describe this concept, generally, as a notion denoting regulated or potentially regulated entities' engagement in exploiting regulatory and/or legal loopholes or differences (Pollman, 2019) in two distinct levels, namely either within or across national/regional jurisdictions (Schwarcz, 2012; Nabilou, 2017;

Willesson, 2017), and thus, by-passing stringent regulation, comparatively to other intra-state or inter-state regulation(s).

Importantly, a diversity of categorisations of this notion, based on different criteria, has been observed (Pollman, 2019) but regulatory arbitrage has been classified mostly into two main distinct categories described by the use of different terminology.[6] On the one hand, there is a situation where companies take advantage of different regulatory rules applicable to functionally similar products/activities (Riles, 2014) within the boundaries of the same jurisdiction (Nabilou, 2017). Riles (2014) calls this situation 'categorical arbitrage', Langenbucher (2019, 2021) adopts the term 'repackaging-arbitrage' and Nabilou (2017) prefers the term 'intra-jurisdictional arbitrage'.

On the other hand, there is what is termed 'jurisdictional arbitrage' by Riles (2014), 'moving-places arbitrage' by Langenbucher (2019) or 'inter-jurisdiction regulatory arbitrage' by Nabilou (2017). All these terms describe basically the same thing: the regulatees' or potential regulatees' strategy of exploiting the existence of differences in a country's legislative/regulatory treatment of homogenous business activities from that of another country or group of countries (Riles, 2014) or, in simple words, firms' choice of a particular jurisdiction just because of its regulatory treatment of the matter at hand (Langenbucher, 2019).

Some commentators describe regulatory arbitrage emphasising this idea solely as the exploitation of differences between two distinct elements: a) the economic substance of a product/service/transaction and b) its legal/regulatory treatment (Fleischer, 2010; Barry, 2011). Similarly, others use the term 'regulatory arbitrage' to describe jurisdictional arbitrage or discuss instances of it (See, e.g., Schammo, 2008; European Commission, 2020b). It appears, in this way, that 'regulatory arbitrage' is limited or, at least, closer to either categorical or jurisdictional arbitrage creating a definitional problem, as a result of which, the other form of regulatory arbitrage, is obviously neglected. A solution to this problem would be twofold: i) the adoption of a broad definition encompassing both forms, like the one provided by Pollman, who defines regulatory arbitrage as "structuring activity to take advantage of gaps or differences in regulations or laws" (Pollman, 2019, p. 567), when a general discussion takes place and ii) the use of the specific term 'categorical arbitrage' or 'jurisdictional arbitrage', or their equivalent terms, when the discussion focuses on one type's particular context.

In addition, regulatory arbitrage must be distinguished from other analogous (Fleischer, 2010; Riles, 2014; Nabilou, 2017) or neighbouring terms, such as 'financial arbitrage' and 'forum shopping'. Financial arbitrage or simply, arbitrage, refers to the situation where companies, aka 'financial arbitrageurs', take advantage of the different pricing of homogenous services or products in different countries' markets (Nabilou, 2017) by purchasing the same product or service at a low price in one

domestic market and just selling it at a high price in another one (Patnoy, 2019; Langenbucher, 2019; Langenbucher, 2021). Academics suggest that this competing practice may lower globally the price of the product or service in question and ultimately, lead to a more efficient market (Partnoy, 2019; Langenbucher, 2021) where price differences are, basically, eliminated and different national markets are more closely connected (Riles, 2014). By analogy, market participants' employment of the regulatory arbitrage strategy "eventually results in the regulatory costs of a certain transaction to converge at the lowest level" (Langenbucher, 2021, p. 4). While the phenomena of regulatory arbitrage and financial arbitrage share some common characteristics, for instance, they are supposed to improve market efficiency (Langenbucher, 2019; Langenbucher, 2021) and involve some form of competition, they have their own idiosyncratic characteristics. In the case of financial arbitrage, the competition takes place amongst market participants and its assumed ultimate result is the reduction of product price. As Partnoy puts it, "financial arbitrage is the key mechanism in the adjustment process that leads to identical goods having identical prices" (Partnoy, 2019, p. 1018). Regulatory arbitrage, by contrast, involves the occurrence of competition between different national regulators and the assumed ultimate result of such competition is the reduction of regulatory costs, not necessarily lowering the product/service price (Partnoy, 2019). Yet, it could also be argued that financial arbitrage involving, by its very nature, different national markets is more closely related to jurisdictional arbitrage, as a specific form of regulatory arbitrage, than to the general concept of 'regulatory arbitrage'.

Furthermore, the notions of 'regulatory arbitrage' and 'forum shopping' are used by some academics interchangeably as having essentially the same meaning. Some scholars use the conjunction 'or' between the terms 'regulatory arbitrage' and 'forum shopping' to imply that they have the same meaning (see, e.g., Barbou des Places, 2003). By contrast, other scholars using the word 'and' as a conjunction between these terms treat them as two *distinct* terms (See, e.g., Walch, 2017). To clarify things, both terms describe instances of market participants' opportunistic conduct (Castellano, 2012), not necessarily coinciding with each other. In fact, some authors tend to attribute the meaning of 'forum shopping' only to what I described earlier as 'jurisdictional arbitrage' (See, e.g., Minto *et al.*, 2021). However, this could be, probably, a rather simplistic view. By examining their definitions, one can spot their fundamental differences. Forum shopping has been defined as "the ability to elect for a (usually) favourable forum" (Omar, 2015, p. 5), which typically interprets and applies its own domestic legislation. On the other hand, regulatory arbitrage (or more accurately, jurisdictional arbitrage) has been defined as "the action by which mobile economic actors seek to take advantage of regulatory differences between jurisdictions in order to reduce costs or to gain an advantage" (Schammo, 2008, p.353). As a result, jurisdictional arbitrage is, by far, a broader term i) entailing a comparison of clearly different applicable jurisdictional regulations and a clear objective and ii) encompassing the practice of forum shopping (shopping, in this case, for a regulator) together with that of 'law shopping', which describes the ability to select/shop the applicable law/regulation, to achieve its goal.

It is true that the different treatment of cryptoassets by different domestic regulators (at least three (3) in each jurisdiction (Blandin *et al*., 2019)), which is by large based on their different cryptoasset categorisation compatible to their pre-existing mandates, may allow considerable space for 'categorical arbitrage' opportunities. For instance, cryptoasset issuers may develop their cryptoassets' characteristics in such a way to avoid falling into a particular cryptoasset category that is heavily regulated in a specific jurisdiction but to conform with the requirements of another less-regulated or non-regulated category in the *same* jurisdiction. However, due to the strong cross-border nature of cryptoassets' activity, the focus of this paper will be on 'jurisdictional arbitrage', a strategy which, in fact, requires moving jurisdictional arbitrageurs' business activity, infrastructure and/or its legal domicile from one jurisdiction having a high-standard and stringent regulatory framework to another jurisdiction offering a more desirable regulatory environment employing less burdensome regulation or, even, no regulation at all.

3. The problem of regulatory arbitrage: An old practice in new shoes?

Regulatory arbitrage is not, actually, a new practice (Fleischer, 2010; Nabilou, 2017). It has followed regulation, perhaps, since its birth (Ringe, 2016). Early cases of this practice involve intra-state taxation avoidance (Nabilou, 2017) and other financial issues, such as avoiding the prohibition of charging interest on loans in ancient times (Knoll, 2008).

However, jurisdictional arbitrage is a more recent phenomenon (Ringe, 2016), which could be easily characterised as an inherent shortcoming of national/regional regulation with a global effect. It has recently attracted attention by firms, regulators and academics, in areas such as the banking sector, where this phenomenon results, *inter alia*, "from a different treatment of capital requirements between the banking systems of different countries/regions…" (Milcheva, 2013, p.5329). It also arises when what has been identified by Fleischer (2010) as the condition of 'regulatory-regime inconsistency' is present. As Fleischer explains, this condition means that "the same transaction receives different regulatory treatment under different regulatory regimes" (Fleischer, 2010, p. 244). This unique form of regulatory arbitrage has taken a novel and increasingly growing dimension in our current globalised era (Ringe, 2016; Nabilou, 2017), where information about different national regulatory regimes and their advantages is widely available online and businesses are free to trade/operate worldwide via the Internet. Therefore, it has become a reality as regards internet regulation, where social media, search machine and online retailing companies' attempt to circumvent strict privacy laws and avoid imposition of burdensome State taxes (Pollman, 2019), and lately, cryptoasset regulation.

4. Cryptoasset regulation: Cause(s) of jurisdictional arbitrage

The emergence of the cryptoasset realm provides an extra dimension on jurisdictional arbitrage and opens a novel discussion about its causes and related solutions in this particular area. Regarding the question about its causes, the answer looks pretty straightforward. One would say that jurisdictional arbitrage is merely the result of existing differences in national views about regulating identical business activities involving cryptoassets. This is quite true, but this issue is rather complex and, therefore, it merits deeper investigation. There are various causes that may either create or facilitate a kind of differential treatment by national/regional regulators which, in turn, leads to jurisdictional arbitrage in the context of cryptoasset regulation. These causes may be summarised as the presence of two phenomena, globalisation and regulatory competition, and the absence of another, international co-ordination, which I'll examine in turn.

First, cryptoassets and their related industry, market activities and operation, know no national boundaries (He *et al*., 2016; Nabilou, 2019), being, in this way, a manifestation of the globalisation phenomenon. The latter has been defined by Drezner as "the cluster of technological, economic, and political innovations that reduce the barriers to economic, political, and cultural exchange" (Drezner, 2005, p. 841). Just like the field of traditional financial assets and services having also a cross-border character (Genschel and Plümper, 1997; Ringe, 2016) and a notable history of jurisdictional arbitrage, such type of arbitrage has become a reality in the cryptoassets' market precisely because of its characteristic cross-border nature. This unique nature has been described by Houben and Snyers, who wrote "crypto-assets […] are created by private actors in various countries all over the world, they are cross-border in their application and infrastructure, and they are easily accessible, transferable, exchangeable and tradeable from nearly anywhere in the world" (Houben and Snyers 2020, p. 66). Exploiting this nature, cryptobusinesses may become 'jurisdictional arbitrageurs' by establishing or moving their legal domicile (Szepesi, 2020) and/or their functional equipment, i.e., their servers (Lehmann, 2020), in a country embracing light-touch regulation or altering/structuring their operational regulations and retaining their trading operations, by using modern telecommunications and IT, across the globe. This opportunistic tactic allows them to remain largely unregulated by most targeted jurisdictions, avoiding in this way, significant regulatory costs and burdens and increasing, undoubtedly, their profitability. Besides this traditional tactic based on exploitation of differences in national approaches and avoidance of strict regulation as a means of profitability, there is also a somehow 'innocent' reason for especially large international firms to become jurisdictional arbitrageurs. They seek to establish themselves in and operate from countries, which adopt clear regulatory frameworks providing legal certainty, stability and security necessary for their firms' development (World Economic Forum, 2021). This argument may be linked to a 'race to the top' having a win-win result for regulators and regulatees. Regulators achieve their objective of regulating in the public interest and regulatees enhance their profitability by operating in a stable, legitimate and regulated environment.

The cryptoasset industry may function via the Internet across the world but its regulation has been undertaken by national policymakers/regulators (International Organization of Securities Commission, 2017), becoming, thus, a highly localised matter. More specifically, the occurrence of cryptoassets, as an unexpected event, has prompted different national/regional regulatory responses, which, in turn, have created a global mosaic of fragmented national regimes. Like financial institutions taking advantage of "fragmented regulatory structure with a variety of norms and standards" (Ringe, 2016, p. 12), this multiplicity and availability of choices, actually, encourages crypto-industry members that operate in this mosaic to select freely a less onerous jurisdiction that satisfies their financial interests. Jurisdictional arbitrage can be described, in fact, as a spin-off of a patchy regulatory landscape which necessarily involves numerous regulatory frameworks with no regulation or regulation of different levels (from lightly-regulated jurisdictions to heavily-regulated jurisdictions). This statement leads to a further significant claim. This type of regulatory arbitrage is not only a by-product of considerably strict regulation. It has been acknowledged that even "optimal regulation does not necessarily prevent regulatory arbitrage" (Frantz and Instefjord, 2018, p. 819). Crypto-market participants are simply free to make an informed decision choosing their favourable regulatory regime from a menu of available choices, after a prudential weighing of the advantages and disadvantages of each jurisdiction's legal and regulatory system and the benefits of relocation vis-à-vis their possible relocation costs. Therefore, while jurisdictional arbitrage, as a type of regulatory arbitrage, may be an "unintended effect of effective regulation" (Nabilou, 2017, p. 563), jurisdictional arbitrageurs' actions are always intended and, certainly, not random. After all, this distinct form of regulatory arbitrage has been described as a "planning technique" (Fleischer, 2010, p. 229).

Unsurprisingly, many cryptoasset market participants, like cryptoexchanges and custodian wallet providers, seeking to increase their profitability, have already exploited the existence of gross differences in cryptoasset regulatory treatment across national borders and they have left strictly regulated jurisdictions. Infamous examples of such migration constitute those of cryptocurrency intermediaries from the New York (Roberts, 2015; Nabilou, 2019), a global financial centre, following the adoption of BitLicense, a regulatory framework creating costly compliance burdens for crypto-businesses, especially start-ups (Willms, 2015), and from the EU area following the adoption of AMLD5[7] (See Pirus, 2020).00000000000 On the opposite side, countries, such as the UK, offer crypto-friendly regulatory environments and, thus, appealing as attractive to foreign cryptobusinesses (Bragg, 2021). In contrast to EU jurisdictions, e.g., Germany, treating cryptoassets, such as Bitcoin, as financial instruments (Huang, 2020), the UK's light-touch regulatory treatment of these exchange tokens is particularly noteworthy.[8] Under the UK regulatory framework, these tokens are only partially regulated for AML purposes and thus, largely unregulated escaping FCA's stringent supervision (Huang, 2021).

Second, national/regional policymakers and regulators often engage in a competition at global level, known as 'regulatory competition' in the form of races, either upwards or downwards, aka 'races to the top' or 'races to the bottom', seeking, respectively, to ensure efficient national regulation serving objectives such as consumer protection or to investment attraction.[9] This phenomenon is not detached from the previously discussed phenomenon of globalisation. It has, in fact, been exaggerated since the latter has increased the number of potential regulatory competition participants (Ringe, 2016) and it has facilitated a diffusion of information amongst national regulators about different national regulatory practices, especially, through international organisations (Drezner, 2001). Such competition alone does not lead directly to jurisdictional arbitrage but it constitutes a process through which differences between national regulatory frameworks become visible and consequently, opportunities for jurisdictional arbitrageurs arise. As Pollman (2019, p. 570) emphasises, "the more that laws can be discretely chosen, the greater potential for regulatory arbitrage" (Pollman, 2019, p. 570). Furthermore, the relationship between these two phenomena is so deeply rooted, as it appears, at least, in two respects. Firstly, the characterisation of the first phenomenon as defensive or offensive depends on its interaction with jurisdictional arbitrage (Ringe, 2016). In contrast to defensive regulatory competition, where regulatory competition reacts to the emergence of jurisdictional arbitrage, in the case of offensive regulatory competition, such competition actually aims to create jurisdictional arbitrage by adopting regulatory frameworks appealing attractive to foreign investments (Ringe, 2016). As regards cryptoasset regulation, no conclusive empirical evidence has been available yet to confirm that any existing regulatory competition has definitely taken place following a downwards or upwards direction. There are only some signs of offensive regulatory competition indicating the existence of attempts of races to the top or bottom. BitLicense was supposed to initiate a 'race to the top' (Ember, 2014) but it clearly failed to do so at an US inter-state level since similar legislative attempts by other US States, e.g., California's Assembly Bill 1326 proposed in 2015, have been unsuccessful (See Finck, 2018; Kim, 2019). By contrast, other jurisdictions have employed regulatory tools, such as regulatory sandboxes or innovation hubs (See Brophy, 2020) and crypto-friendly legislation, as means to attract foreign crypto-investments, sparkling fears of a 'race to the bottom' (Mueller, 2017). On the other side of the spectrum, there are no signs of defensive regulatory competition since jurisdictions that adopted explicitly strict regulations, e.g. the New York State, have not yet relaxed them.[10] Secondly, jurisdictional arbitrage, being "an indispensable element of regulatory competition" (Nabilou, 2017, p. 557), acts as a means of delivering "the benefits of regulatory competition [...] [by providing] alternatives or regulatory substitutes for regulated firms" (Nabilou, 2017, p. 557, 575). Again, if there is only small-scale competition amongst different national regulators, jurisdictional arbitrage fulfils this role only in a limited way.

Finally, the absence of international co-ordination as a condition for national/regional regulators' differential treatment of a specific matter has been stressed. For example, Riles points out, "regulatory arbitrage depends on a rich ecosystem of diverse regimes and types of law, which are not organized into any clear, coherent, hierarchical whole" (Riles, 2014, p. 72). In the same vein, Nabilou states that "absent international financial coordination, regulatory arbitrage may arise across various national jurisdictions" (Nabilou, 2017, p. 565). As regards most aspects of cryptoasset regulation, there is currently, and possibly for the foreseeable future, an absence of international co-ordination acting as a strong impediment to the occurrence of jurisdictional arbitrage. As Blandin *et al*. put it, "the lack of harmonised and coordinated regulatory responses allows cryptoasset market participants to exploit regulatory loopholes and circumvent stringent regulations" (Blandin *et al*., 2019, p.54). Apart from the specifically targeting harmonisation efforts of the Financial Action Task Force (FATF) through mainly its soft-law Recommendations, there is, presently, an absence of 'hard law' solutions in the form of an international body assigned with the task of co-ordinating its members' national cryptoasset regulatory efforts and a treaty containing rules/standards for future national implementation. Both solutions could minimise the differences between substantive national laws and drastically reduce jurisdictional arbitrageurs' choices. Last but not least, this absence of co-ordination also fuels regulatory competition and does not adequately address the negative effects of globalisation, which lead (indirectly) to jurisdictional arbitrage.

5. Solutions to the problem: Seeking a remedy nationally or internationally?

Undoubtedly, jurisdictional arbitrage has some advantages. It may provide, as stated above, attractive regulatory alternatives to regulatees (Nabilou, 2017; Langenbucher, 2019). It may also provoke the establishment of new regulatory frameworks (Willesson, 2017) or it may eventually lead to a reduction of certain regulatory costs globally (Partnoy, 2019; Langenbucher, 2021). However, its negative effects certainly outweigh any benefits. Starting with national level, jurisdictional arbitrage, as a detrimental business manoeuvre, has the potential to undermine the efficiency of regulatory supervision (Zetzsche *et al.*, 2020), the rule of law (Fleischer, 2010) and the affected country's State sovereignty and domestic economy (Riles, 2014). It may also undermine the market's integrity (Johnstone, 2020) and may create unfairness for the regulated entities under the circumvented regulatory framework (Willesson, 2017). In a nutshell, "regulatory arbitrage is […] an action against the effects of regulation" (Willesson, 2017 p.73). At the international level, this type of regulatory arbitrage externalises regulatory costs (Fleischer, 2010) and may constitute a cause triggering regulatory competition amongst different jurisdictions (Nabilou, 2017), particularly, a 'race to the bottom' where States adopt low-standard regulatory requirements, often at the expense of domestic and offshore consumer protection (Lehmann, 2020), in order to attract business-related investments. In reality, many jurisdictions previously labelled as 'tax havens' (Lehmann, 2020), are now featuring as 'blockchain havens' appealing to the potential foreign

investors and, in doing so, they are adopting low-standard or, even, no cryptoasset regulation at all (Marian, 2019).

Under these circumstances, it can be concluded that 'jurisdictional arbitrage' occurs inevitably in any case, it cannot be eliminated as a result of its intrinsic amalgamation in each individual national regulatory regime and in the global regulatory mosaic as a whole, and it is damaging in many respects. Consequently, relevant solutions must be sought to tackle this problem effectively. As part of the academic debate on regulatory arbitrage, various scholars have referred to a number of remedies to deal with this problem from different perspectives, ranging from those relating to national law (Barry, 2011; Langenbucher, 2019), including a private international law solution (Riles, 2014), to international 'soft law' solutions (Nabilou, 2019).

The first and, perhaps, the most obvious solution would be the enactment of better designed national/regional laws tracking more closely a transaction's financial substance (Fleischer, 2010; Barry, 2010) or balancing regulation's benefits with compliance costs (Nabilou, 2019) and the creation of efficient national regulatory frameworks containing anti-evasion rules (Pollman, 2019). While these solutions, especially the proper crafting of national legal rules, could probably have a fruitful result in combating categorical arbitrage (Langenbucher, 2019) -a purely intra-jurisdictional phenomenon, they would probably have no or limited effect in the context of jurisdictional arbitrage because differences between jurisdictions in the international sphere would still be present. Other attempts by legislators trying to hinder business relocation or shift of trading operations into other jurisdictions face also practical difficulties, especially in terms of enforcement. Even policymakers' attempts aiming to attach an extraterritorial effect to their national laws has been proven to be ineffective. For example, national/State legislation intended to create unilaterally an anti-avoidance effect by applying beyond its strict territorial boundaries, or in other words, having extraterritorial effect, such as the BitLicense applying to any Virtual Currency Service Provider (VCSP) dealing with New York residents (Nian and Chuen, 2015), failed altogether to combat jurisdictional arbitrage and many businesses fled New York seeking refuge in another more 'crypto-friendly' State. As a result of this discussion, the following conclusion may be drawn: national policymakers/regulators cannot address jurisdictional arbitrage by providing national answers to such an international problem. The potential answers to the problem of this type of arbitrage may be found in the problem itself, especially in the causes of differential national cryptoasset regulations.

Even effective and, simultaneously, costly national regulation (Nabilou, 2017) in one or some countries, due to cryptoassets' unique cross-border nature and lack of harmonised laws in all countries around the world, creates transnational regulatory differentiation coupled with level asymmetries, which, eventually, causes jurisdictional arbitrage. Thus, harmonisation of regulatory standards and related laws

on international level has been suggested as a proper measure solving or at least mitigating jurisdictional arbitrage (See Lim, 2015; Sotiropoulou & Dominique Guegan, 2017) since legal uniformity drastically reduces differences and, most importantly, creates identical regulatory costs worldwide (Riles, 2014) removing or diminishing significantly jurisdictional arbitrageurs' motivation to migrate elsewhere (Macey, 2003). In short, as Pollman puts it, "the greater the extent to which a law is bundled, the less room there may be for regulatory arbitrage to function as a valuable strategy" (Pollman, 2019, p. 570). Unfortunately, such harmonisation, which could be ideally the best approach to the global co-ordination of different national regulatory schemes and the perfect solution to the problem at hand, is a process facing serious problems in practice (Riles, 2014) and not guaranteeing total harmonisation as a final product. Let aside any potential enforcement problems, there may be problems occurring throughout the process of formal law-making from negotiation, conclusion of an international treaty to its national implementation. Riles (2014) identified a number of these problems including the possibility of States' disagreement, potentially fuelled by their own domestic economic and political interests, on the content of the international substantive norm(s); the possibility of drafting a complex binding instrument generating legal gaps or financial engineering opportunities exploitable by the regulatees; and its intrinsically flexible character in implementation since different jurisdictions may transpose very differently harmonising legal rules creating practically, new jurisdictional arbitrage opportunities for market participants.

Some commentators limit the harmonisation paradigm exclusively to public international 'hard' law solutions, namely, a set of substantive legal rules created via an international body, applying internationally and being enforced domestically (See, for example, Riles, 2014). This solution, currently, appears totally unrealistic but there are still other solutions based on the so-called 'soft law' designed to overcome the classic practical problems accompanying 'hard law' as a harmonising mechanism. In this way, a certain flexibility for implementing national laws and regulatory pluralism, described as a "positive dimension of global financial markets" (Riles, 2014, p.83), may still exist. Adopting a 'soft law' approach means that a number of countries, normally, those with global economic and regulatory power, e.g., the USA and EU, take the lead, put aside their differences, co-operate and agree on certain standards/rules (Drezner, 2005). Subsequently, their agreed international standards/rules can be adopted by other countries through an international soft law mechanism. For instance, the FATF which was established by the Group of Seven (G7) and the -then- EC Commission and its Recommendations currently form the globally accepted anti-money laundering (AML) standard towards which the vast majority of countries around the world should harmonise their own respective domestic laws (Drezner, 2005) and they are enforced by FATF employing tactics such as peer evaluation, blacklisting and strong endorsement by international organisations and informal networks like the United Nations (UN) and the Group of 20 (G20).

Adoption of commonly agreed standards, at a global level, is not a complete solution. As illustrated by FATF's Second 12-Month Review of Revised FATF Standards (Financial Action Task Force, 2021), a *conditio sine qua non* for the success of this remedy is all individual States' consistent implementation. In FATF's own words, "[..] uneven global implementation of the revised Standards, with large number of weakly compliant or non-compliant jurisdictions leading to jurisdictional arbitrage [..]" (Financial Action Task Force, 2021, p. 3). By employing soft law as a harmonising mechanism and, thus, turning harmonisation's absence into presence in the regulatory realm, the national/regional laws will be aligned with each other, there will be no sufficient ground for regulatory competition and the effects of globalisation will be properly addressed. Put it simply, regulatory differences among States will be limited, if not eliminated, by the adoption of same or similar domestic regulatory rules. For market participants, there won't be substantially different frameworks to choose from.

Interestingly, another solution to the problem would be States' engagement in regulatory competition. Paradoxically, such competition, which generates a fragmented international regulatory landscape and consequently, an opportunity for jurisdictional arbitrage by the regulated entities (Héritier & Schoeller, 2020), may, also, be a mechanism leading to (often, partial) regulatory convergence (Drezner, 2005) which, in turn, helps to reduce such opportunity (Fleischer, 2010). Thus, a global financial regulatory power, e.g., the EU, engaging in a so-called 'race to the top' by adopting high quality regulation, may persuade the USA, its regulatory counterpart, to adopt a similar regulatory framework or it may attract supporters in the international arena and form a powerful group of countries sharing, in the long term, the same or similar regulatory frameworks (see Drezner, 2005). Currently, the European Commission has taken the lead in the international cryptoasset regulatory arena by proposing its MiCa that certainly forms a measure against regulatory arbitrage, at least, at European Union level. This proposed Regulation supplements existing EU legislation covering financial instruments and electronic money by specifically addressing 3 categories of cryptoassets (utility tokens, e-money tokens and stablecoins) that fall outside its existing regulatory perimeter (Ahern, 2021). Moreover, according to MiCa, crypto-asset service providers (CASPs) wishing to operate in the EU, must fulfil two requirements: 1) they must have a registered office in an EU Member State and 2) they must acquire an authorisation by a competent national authority (European Commission, 2020b). In addition to practical difficulties in a borderless online environment, in terms of enforcement, the MiCa proposal has initiated a regulatory competition in the field driven by the European Union's ambition "to become a global standard-setter" (European Commission, 2020a) and, if it is finally adopted, it will harmonise the applicable cryptoasset laws across the EU (European Commission, 2020b). However, given the previous experience of AMLD5's failure to become an arbitrage-proof legislative piece due to its regional application, the "arbitrage-proofness" of this proposed legislative measure is also highly doubtful for the same reason. While this Proposal is an ambitious piece of legislation eliminating, in case of its adoption, regulatory fragmentation in the EU area (European Commission, 2020b), it will still remain only a regional

harmonising measure that reduces partly global regulatory fragmentation. It remains to be seen how the USA will react to EU's MiCa and its future adoption.

6. Concluding Remarks

Jurisdictional arbitrage, an inherent shortcoming of national/regional regulation with a global effect, has emerged as a significant problem for policymakers and regulators alike. As a result, the debate about possible solutions to this problem, in the broad context of regulation, is also relevant to cryptoasset regulation. Ultimately, it may be argued that there is no elixir for jurisdictional arbitrage (Nabilou, 2019) but, contrary to the somewhat extreme view that there is no legal solution in this context (Langenbucher, 2019), there, at least, two alternative remedies, suggested above, that may, in fact, limit it. While harmonisation of regulatory rules is, practically, a difficult task, commentators still propose a co-ordination approach at international level (Auer and Claessens, 2018; Cuervo *et al.*, 2019; World Economic Forum, 2021) in order to minimize any differences of national regulatory frameworks, which lie at the core of the problem. Here, the FATF, a successful transgovernmental network, and its Recommendations could serve as an example setting a precedent for any future international discussion about harmonising, at least, certain aspects of cryptoasset regulation and calibrating appropriate legal instrument(s) for that purpose. It is also hoped that European Union's ambitious strategy, at this early stage of regulatory competition, would pave the way towards that direction. Anyway, it can be concluded that any future global efforts to make cryptoasset regulation more convergent, would result in making potential jurisdictional arbitrageurs' motivation to relocate where, in their view, the grass is greener, simply fade away.

[1] Initially, the term 'Bitcoin' referred to all existing cryptocurrencies (See Blandin *et al*. 2019).

[2] A virtual currency has been defined as "a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status […] in any jurisdiction" (Financial Action Task Force, 2014, p. 4).

[3] A cryptoasset has been broadly defined as "a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology" (European Commission, 2020b, p. 34). This term is used throughout the present paper.

[4] For a discussion of conflict of laws issues regarding cryptoassets see, for example, Bell and Cainer, 2020.

[5] See, generally, Langenbucher, 2019, p. 1 for a number of different definitions.

[6] The use of different terminology by commentators has no practical importance since these concepts refer, respectively, to one of the two main categories of regulatory arbitrage and the wordings of their definitions do not substantially differ. In this article, the terms 'categorical arbitrage' and 'jurisdictional arbitrage' are used to describe these two main categories.

[7] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018.

[8] The UK Financial Conduct Authority (FCA) recognises four types of cryptoassets, namely e-money tokens, security tokens, exchange tokens and utility tokens. The first two of these cryptoassets are regulated and the remaining two are unregulated (See Huang, 2021).

[9] There is, in fact, extensive academic literature on the issue of regulatory competition and its 'races'. See, e.g., Radaeli, 2004; Holzinger, Knill, and Sommerer, 2008; and Carruthers and Lamoreaux, 2016.
[10] For BitLicense's brief history, see https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/regulation_history.

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