

PHASE 5a

Considering Trustworthiness



**begin
blockchain**



enabling new growth for sme's

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This is an optional module

Blockchains are pseudonymous (except some exceptions that include privacy-oriented blockchains), and if the project requires some sort of private data to be held, there is a need to reconsider the use of a blockchain.

- In the case of a consortium network, if a number of companies share a blockchain, the activities of the others are in principle visible to each other, and this may reveal information or activity to competitors.
- Further, there is in general a consideration of ethical use of blockchains with regards to the business model. Users are in many cases unaware of consequences of their use of the DApps due to the technical complexity of the solution, and this needs to be accounted for.



In this step, we reconsider the position of our current solution and business model from a different dimension, looking at regulation, ethics and, in general, societal impact.



From the regulatory standpoint, it is important to know that this step requires studying some country-specific aspects since regulation in the blockchain space is emerging, in some cases difficult to interpret, and varies widely across jurisdictions. Some jurisdictions are banning in some way some blockchain-related activities, while others have assimilated part of them in their existing regulations, and in others, most of the aspects of these activities

are still in some sort of regulatory “limbo”. In consequence, the tutor here needs to carefully examine the intended or projected jurisdiction of the entrepreneurial projects and adapt the discussion to the regulatory jurisdictions of the companies and their intended customers. Therefore, the support of a legal advisor is strongly recommended here.

From the viewpoint of **PRIVACY AND CONFIDENTIALITY**, we shall at least consider here the following:

- Blockchains identities are pseudonymous (except for some exceptions that include privacy-oriented blockchains), and if the project requires some private data to be held, there is a need to reconsider the use of a blockchain, both for ethical reasons and also for regulatory compliance.
- In the case of a consortium network, if a number of companies share a blockchain, the activities of the others are in principle visible to each other, and this may reveal information or activity to competitors.

From the viewpoint of **CORPORATE LAW AND FINANCIAL REGULATION**, there may be a number of elements to be considered carefully, including the following:

- The current regulation of blockchain related activities in the jurisdiction of the company.
- If using some form of DAO as governance structure, how does that fit with current corporate law at the chosen jurisdiction. This may include some forms of initial crowdfunding.
- If using some form of token or service that has some analogy with financial services, how financial regulations, including KYC and AML, affect your model.

Further, there is, in general, a consideration of the ethical use of blockchains with regards to the business model. Users are, in many cases, unaware of the consequences of their use of the DApps due to the technical complexity of the solution, and this needs to be accounted for.



This, in general, touches how to **INTERACT WITH STAKEHOLDERS AND USERS**, including the following:

- How would users or node participants in case needed (e.g. miners or validators) be engaged so they trust and feel the solution is adequate for their needs?
- In case of a solution that is a platform for others to build on top, how would developers and partners be onboarded, which is the narrative to join?
- Are there hidden costs or negative externalities that can be attributed to your activity? Some may seem evident, such as the environmental impact of PoW mining activities, but others as the financial risks for poorly informed individuals may be more difficult to evaluate.
- In general, how does your business integrate something valuable to society in its mission?

This step takes us outside of the technological view and considers the business model in its broader societal dimension. Even though some of the considerations tackled here may have yet surfaced in previous steps, at this point we have a clearer picture of the technology and the business model, and we are able to better assess its implications.

The decision point to move to the next step is having a clear understanding of the legal risks and, in general, the legality of the business and understanding other broader ethical concerns.

The basic problem in the public space is that L1s (as Ethereum) are expensive to use and slow for some applications, and there is a wide variety of solutions that build on top of them to give more speed and lower fees. However, in the blockchain space, this is always a tradeoff, and the critical point is to

understand how the particular solution and tradeoff chosen affects our users and if this appears to be acceptable for them. It is possible that the discussion on L1 and L2 may have already appeared in the previous stage. In that case, this can only be a check or validation.

Particularly, consider and discuss for privacy:

- Are we storing personal data in the blockchain or in any other complementary component (e.g. a decentralized file system)?
- Is it essential to record that data in the blockchain? Maybe some parts may be stored in traditional databases, which are “regular business” concerning privacy regulation. Does that traditional database compromise decentralization?
- Does the use of private blockchains, if viable for our need, solve part of the problems?

In general, even addresses are considered private data by the GDPR since they are pseudonymous, so they can be combined with other data to identify individuals. Typical solutions to this are storing hashes in the blockchain, but this is again pseudonymous. In consequence, in general, all personal information and even pseudonyms should ideally not be stored in the blockchain.

Other solutions to this project involve storing hashes of encrypted files, but this shall not be considered a general solution but a last resort in case there are no alternatives. In general, it is possible to minimize the storage of personal data in the blockchain by relying on other mechanisms that complement the use of the blockchain. This is a complex technical topic, and if the solution is not obvious, this is a point in which the intervention of a technical advisor would bring a lot of benefits.

And if confidentiality in business networks is required, consider, and discuss:

- Which information pieces can be made public to the whole consortium, which to only some of the participants, and which to only the two interacting partners in a transaction?
- Which are the negative impacts for a business of not having confidentiality for the elements identified in the previous question?
- Do these negative impacts affect the feasibility or sustainability of our business model?

*In a **consortium blockchain**, the incentives of businesses to participate are at least partially driven by the confidence they have in that sharing information will not be detrimental to their business. In some cases, revealing prices and transactions are a source of “competitive intelligence” that they will be reluctant to share as it will be detrimental to their interests.*

Of course, this problem of disclosure of business-related information also appears in public blockchains, but in the case of private or permissioned networks the analysis may be more difficult. The first important element to consider is privacy and confidentiality. For privacy, regulations as the GDPR offer a solid foundation to evaluate

your business. In the case of confidentiality concerns for business actors, you would need to go back to the design of the business network of the consortium. The first important concept here is using Layer 1 (L1) and Layer 2 (L2) blockchains and the security, maturity and decentralization/security.



RESOURCE 1:

Blockchain and the GDPR

The European Commission published a study on the issues and challenges blockchain poses to the GDPR. The study was intended to propose policy options in Europe, but it can be used as a point of departure for the analysis of this non-easy topic.

It is particularly important to understand the incompatibility of GDPR “right to erasure” of personal data with the general attribute of blockchains that make it onerous and complicated to erase data in general. While there are some technical solutions to that erasure, they are not

adopted in major blockchain implementations as they are perceived as incompatible with the immutability of blockchains.

At this point, you have to consider **three major elements**:

01

Your business will be based on some jurisdiction,

02

Your customers, in most cases, are likely to be international.

03

If your solution involves the spawn of some form of DAO for the decentralized governance of a protocol, or some aspects of the service, this may have legal implications.

You have to consider and discuss the following:

REGARDING 01

- Which are the applicable regulations to my business with regards to the use of blockchains technologies (if applicable)?
- If my company is acquiring some form of blockchain asset as tokens, how does tax regulation affect my business?
- If my company is providing some form of financial service via the blockchain, how do KYC and/or AML regulations affect my business?

REGARDING 02

- How does the fact that my customers are international affect my business?
- Do I need to carry out full KYC to comply with regulations even if the users are in other jurisdictions?

REGARDING 03

- How do the law and my business (the legal entity) interact with each other?
- If the DAO is truly autonomous, but my business has some degree of control, at least in the initial stages, does this affect regulatory compliance?

DD. As mentioned, this part of the discussion and study may require significant effort to find out about national or regional regulations. The possibility of having some professional legal advice would be beneficial to this task.

RESOURCE 2:

Crypto regulations around the world

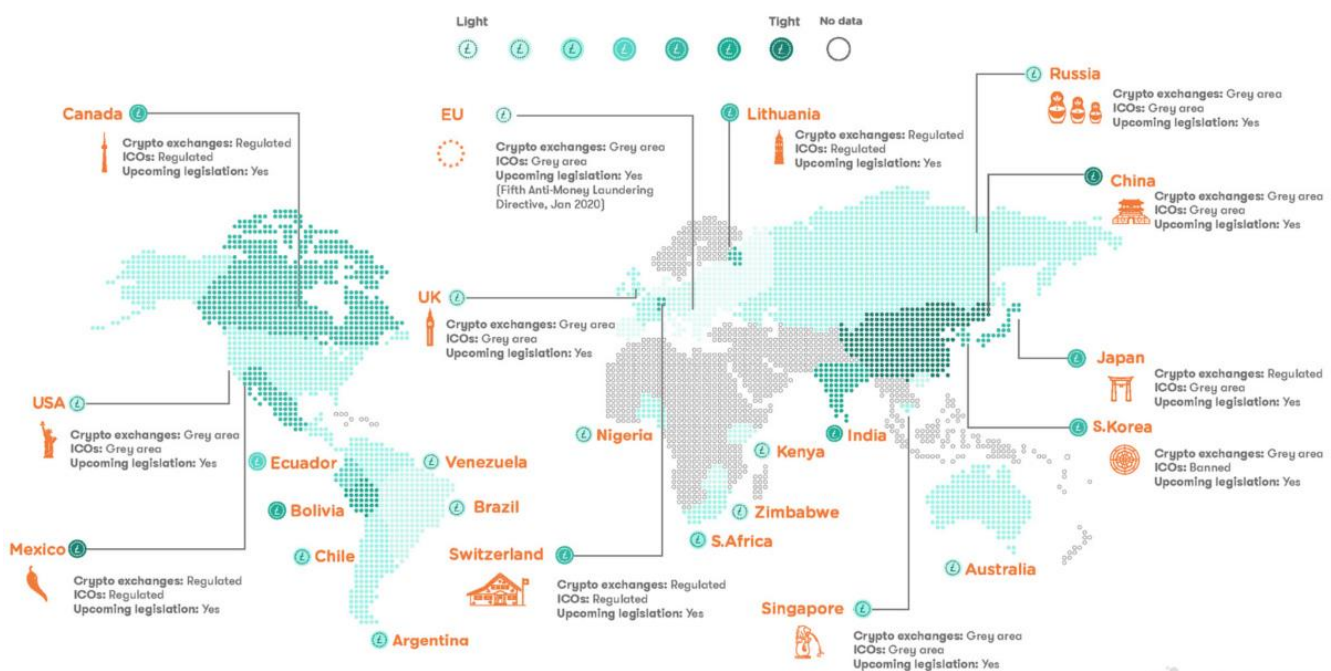
Regulation in the blockchain is a moving target, and in the current state of affairs, it is likely that changes will happen from what is provided here.

While some businesses will be intended for a concrete jurisdiction from the beginning, in some cases, entrepreneurs are comfortable with the idea of moving abroad or being “digital nomads”. For that reason, it might be interesting to start from a map or general overview of global crypto regulation, even if it is just to identify more “crypto-friendly” jurisdictions. There are different maps and resources that attempt to give this overview, although they become outdated quickly.

An example is the following [map](#):

Crypto Regulations by Country

How do different countries around the world approach crypto-regulations?



The light-to-tight regulation scale is based on the following criteria: are Cryptocurrency Exchanges and ICOs banned, regulated or operating in a grey area? Ban = 3 points, regulated = 2 points, grey area = 1 point, Legal Tender? Yes = 1 point, No = 0 points. Is there any planned legislation to increase crypto regulation? Yes = 1 point, No = 0 points. Data collected by ComplyAdvantage should be used as a guide and never taken as legal advice.

ComplyAdvantage

As a first approach to the task, looking at differences across countries can be illuminating, so that later the team may zoom in a particular region or country.

Once the **regulatory aspects are clear**, we still need to **understand the impact of our business** at least at **two levels**:

01

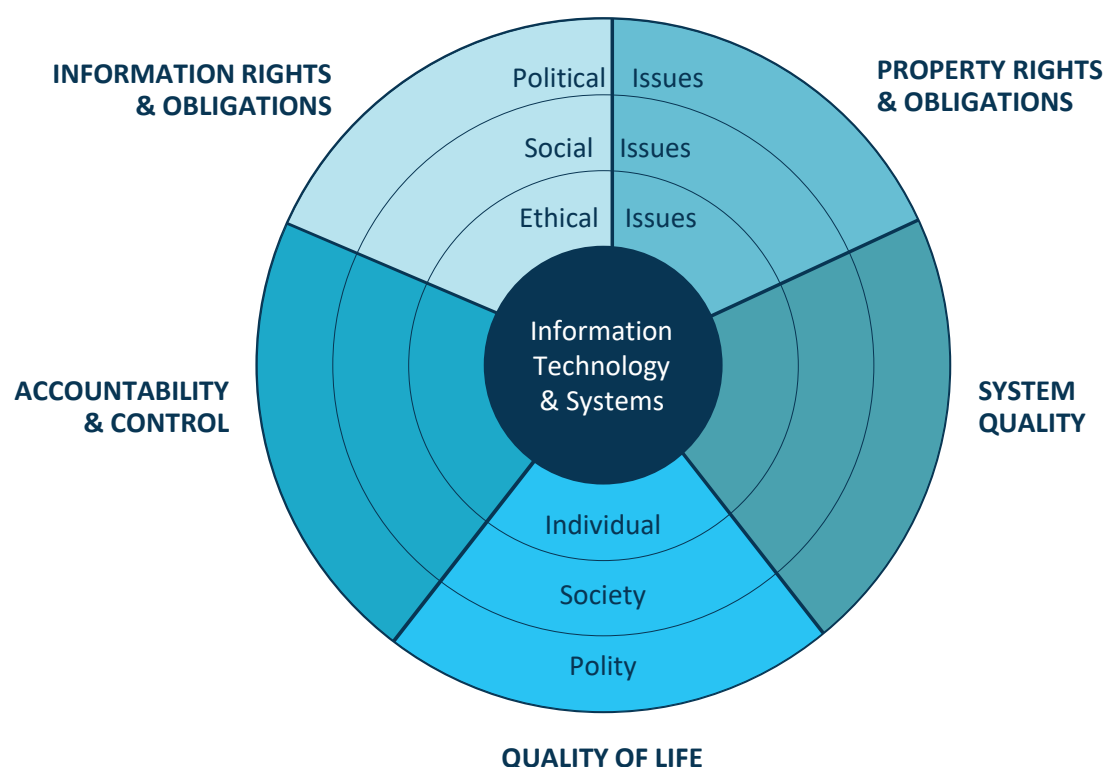
The users of our service, be they final users, developers, miners, validators, or other actors.

02

Society, in general, or maybe the environment.

*In this last step, we take a **final even broader view of the business designed so far**. Some projects will need to look at this more carefully than others, so some consideration from the tutor before starting may be beneficial if the group cannot identify key ethical issues.*

A blockchain service or application is an instance of an information system, i.e. a socio-technical system that combines technology with people and processes. Different generic IS “ethical frameworks” are regularly used to analyze these dimensions. Maybe one of the most popular is the one included in the Management IS textbook of Laudon&Laudon, which is summarized in the following diagram, which can be used as the starting point for a comprehensive analysis at this point.

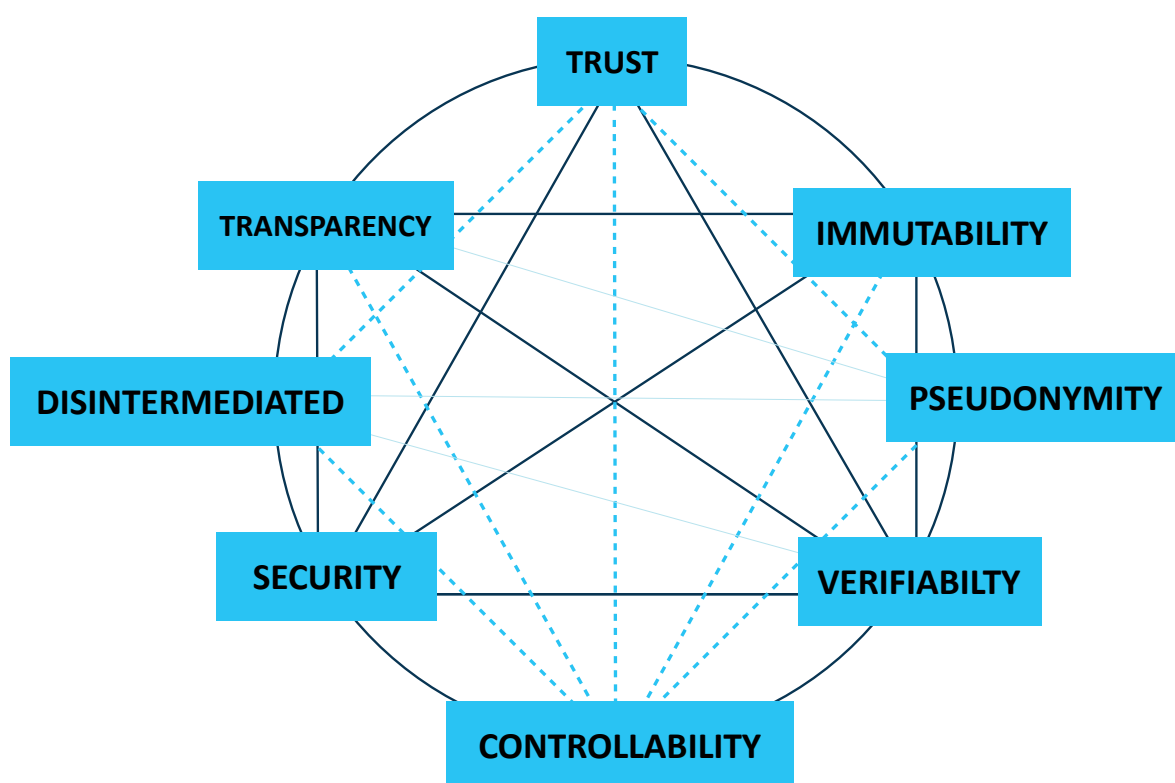


RESOURCE 3:

The blockchain ethical design framework

While generic IS ethical frameworks may be sufficient in many situations, the “Blockchain ethical design framework” by Lapointe & Fishbane provides a more specific account for blockchain technologies.

The authors discuss “why intentionality of design matters, identifies the key questions that should be asked and provides a framework to approach the use of blockchain, especially as it relates to social impact”. They start with a review of blockchain solutions' key attributes that are summarized in the following diagram.



And then discusses some “social goods” applications of blockchain technologies.

The narrative of “blockchain for social good” is frequently found in some solutions and protocols. Maybe that is also the case of the business model of a group, and it was considered from the beginning. But maybe that “social good” angle was neglected, and it can be incorporated here.

The framework itself is depicted in the following figure. The phases depicted in red at the upper part of the diagram have already been done except for the ethical approach, which can be now incorporated. Also, many of the elements in the design spiral have most likely been addressed in previous steps, but the diagram is of help to revise them under a new light to understand if some aspect was missing that may require refinement or reconsideration of design options.

RESOURCE 4:

Blockchain and the environment

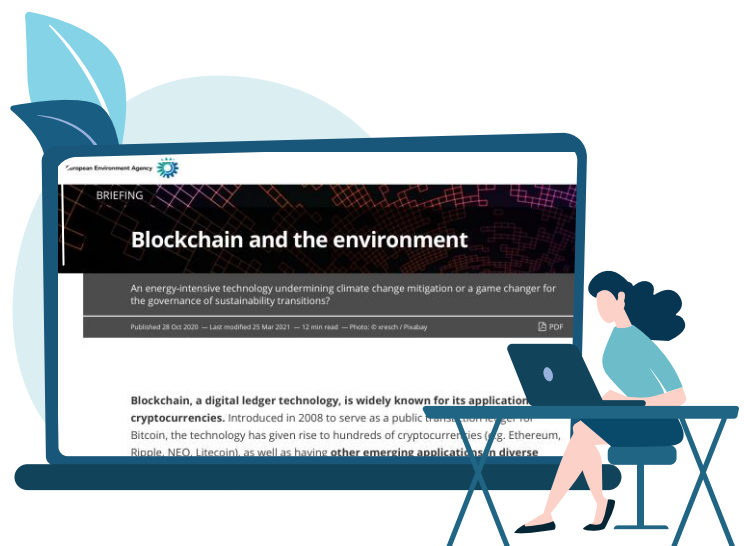
Blockchain systems often involve mining to confirm transactions. This essential process allows transactions to be validated and added to the blockchain, but unfortunately, it involves the use of vast amounts of energy.

A typical example is that of Bitcoin's miners' consumption, which has been estimated at around 91 terawatt-hours of electricity annually, more than consumed by Finland, a nation of more than 5 million people.

On the other hand, miners say they use lots of renewable energy that may otherwise be lost, such as wind power surpluses or hydropower. Estimates range Bitcoin mining energy being from 39% up to 74% renewably sourced. So, there is a lot of debate about blockchain's benefits against energy use and

environmental impact. The European environmental agency has published a briefing on the issues and challenges blockchain poses to the environment, which can be accessed [here](#).

It is important to understand the problem and its different implications, but also to know the main related EU policies such as the 2030 Climate and energy framework, the Environment action programme to 2030 and the EU Trade policy, among others



At this point, you would have *assessed your proposal under a different lens*. However, this may require that you reconsider *some decisions taken and maybe even step back and change part of your business proposal* or technical decisions. This is to be expected in many proposals, and it may require, in some cases, some serious reworking. The trainer should not bias the decision on iterate or progress, but any missing elements not discussed that may affect that decision should be raised. Here it is crucial to manage eventual changes in the business model or technological platform selected that may require some form of stepping back that may be troublesome to manage.



SOME DOUBTS ON REGULATION, ETHICAL ISSUES OR IMPACT

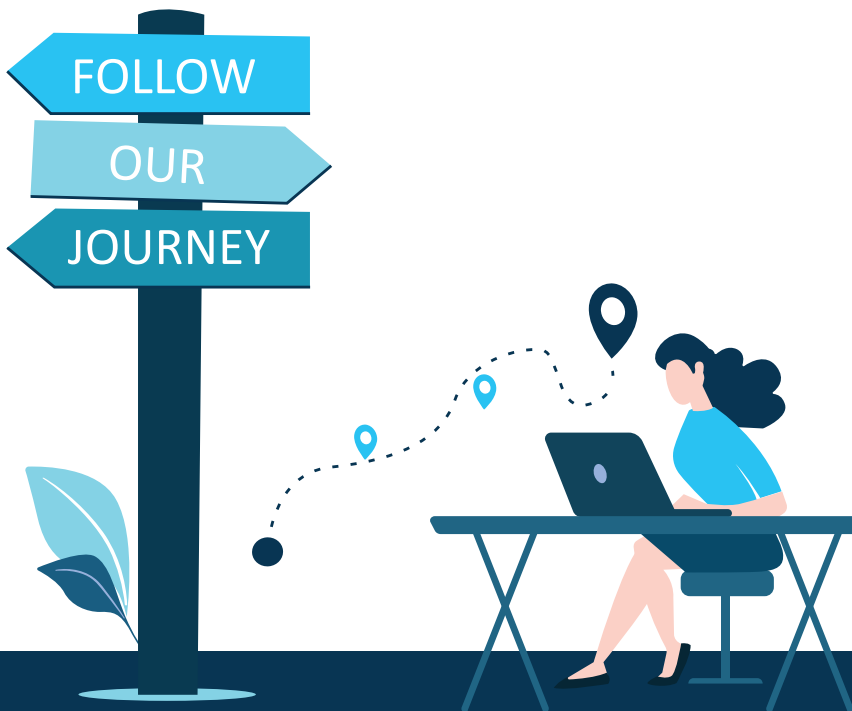
- Depending on your proposal, this step may take less or more effort. Maybe you decided to consider each of the aspects one after the others, and then you simply need to iterate several times.
- In any case, this would require significant effort, and you should, at a minimum, have clear that your business is complying with regulations.
- In this module, maybe you have even to step decided to step back to considerations of previous steps, even to reconsider the use of blockchain in itself! Do not be hesitant in those reconsiderations even if they seem painful or in some way disappointing at this moment.



YOUR BUSINESS MODEL IS TRUSTWORTHY

- Congratulations for reaching this point
- You have now to move to the last step **“5b Infrastructure, Options And Barriers”**. That last step is optional, but in any case, the team must consider taking it or at least looking at the end of the step, to understand that this is more a beginning of your journey rather than an end to it.

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