



Bermuda's FinTech Triangle: Blockchain, ICOs and Virtual Currencies

Author:

Chris Garrod, Director

On November 22nd 2017, Bermuda's Premier, the Hon. E. David Burt, JP, MP held a press conference regarding the potential impact of blockchain on Bermuda's economy. In summary, he said that the Island was going to look at blockchain opportunities as a new aspect of its overall economic plan, seeking to attract initial coin offering (ICO) and cryptocurrency businesses to Bermuda through the introduction of a sensible and credible regulatory framework.

Bermuda's blockchain approach

From a financial standpoint, the starting point was this: broadly, two different categories of blockchain vehicles would be recognised:

- (1) Issuers who were conducting ICOs for crowdfunding purposes would be regulated by amendments to Bermuda's existing Companies Act and Limited Liabilities Companies Act legislation (the ICO Act).
- (2) Issuers of virtual currencies and those operating digital asset exchanges, as well as anyone providing services related to digital assets (e.g. those operating digital asset exchanges, e-wallets and similar structures), would be regulated via a brand new piece of legislation, the Digital Asset Business Act 2018, and by Bermuda's primary regulator, the Bermuda Monetary Authority (BMA).

The ICO legislation

The ICO Act was drafted primarily by the legal department of the Government's business development unit, in consultation with other Government stakeholders, the BMA, the Bermuda Business Development Agency, external consultants and various private sector representatives, including law firms and technology-based companies. This collective approach is the Bermuda standard: new laws, rules and regulations which will have an impact on the Island's economy are created through collaboration between the public and private sectors to ensure the best possible result is achieved.

The new ICO Act regulates offerings of "digital assets", which are meant to capture all of the various categories of digital coins and tokens (whether they be utility tokens, security tokens, equity tokens or otherwise) which are being issued as ICOs and via token sales. It excludes rewards programs and gaming platform-related tokens.

Under the new ICO Act, an ICO will be treated as a restricted business activity that will require the consent of the Minister of Finance prior to an offering being made to the public. A FinTech Advisory Committee will be appointed to assist the Minister with initial reviews of applications and to ensure that they meet certain minimum criteria set out in the offering document issued to the public in connection with the ICO. In most cases, this offering document will consist of the issuer's white paper.

A company (or LLC) wishing to launch an ICO can set up within the typical timeframe of 24 to 48 hours using Bermuda's usual incorporation procedures. However, it will not be able to commence its ICO offering without first obtaining the Minister's consent (which means that the applicant should file a copy of its draft white paper with the Ministry of Finance prior to the ICO).

The minimum criteria for the offering document include details about:

- the founders
- the implementation of the ICO
- the proposed target market
- the amount of money to be raised
- the digital assets rights
- the technology which will be used.

Most of the criteria are industry standard, but the aim is to ensure they are imposed on issuers via statute and regulations.

The issuer will also be required to collect, verify and maintain customer identity information from an AML/ATF perspective.

The provisions of the ICO Act are largely similar to the provisions of Bermuda law which relate to initial public offerings, including requirements to file the ICO offering document with the Registrar of Companies (Registrar) and to file updates of the offering document with the Registrar on an ongoing basis. The ICO Act requires issuers to include a general risk statement (e.g. what happens if the project fails and what is the impact on proposed investors) and imposes penalties for untrue statements.

Bermuda works hard in all its industry sectors to attract the best business to the Island and it has always gone for quality over quantity. In seeking to attract ICO issuers, it is committed to the same approach. Those issuers who do not make the cut will have to choose another jurisdiction.

The Digital Asset Business Act

The Digital Asset Business Act 2018 (DABA) is unique piece of legislation, and the Bermuda Government, the BMA and their advisors looked carefully at the recommendations set out by the Financial Action Task Force (FATF) in this space. Through the DABA, Bermuda is seeking to balance its desire to embrace the new technology with the need to ensure that its pristine international finance reputation is protected. As Bermuda's Minister of National Security, Wayne Caines, stated at an event in February 2018: "The biggest challenge is reputation. Bermuda has only one thing it trades on and that is its reputation." Again, the Island wants to ensure that the business it attracts in this space consists only of high quality participants.

When drafting the DABA it was recognized that virtual currencies and digital asset or currency exchanges were largely unregulated across the globe, and therefore looked to FATF's emphasis on employing a risk-based approach in considering AMF/ATF risk, especially the need for regulatory supervision over public disclosure requirements, fraud prevention, price manipulation and ensuring the integrity of an issuer's owners.

In order to create an effective risk-based approach and regulatory regime, the DABA does not regulate companies which conduct ICOs as a funding mechanism for their own business—that comes within the scope of the ICO Act as set out above. The DABA is concerned with virtual currencies and digital asset or currency exchanges.

The DABA licensing regime consists of two classes: a full virtual currency licence (Class F) and a sandbox licence (Class M). The latter is designed to allow for novelty start-ups looking to test new products or services for a defined period of time (which can be extended), with modified requirements—all under the supervision of the BMA. The intention is to attract innovation to the Island while ensuring customer protection.

Other general requirements of the DABA include matters which one would expect: ensuring the owners and management are fit and proper; that there is sufficient corporate governance in place; and that the business is conducted in a prudent manner. There are also provisions relating to consumer protection: public disclosure rules (for instance, whether the issuer has cyber theft insurance) as well as requirements for certain minimum cyber security measures (e.g. policies relating to hot and cold wallets and generally what provision is made for the protection of customer assets).

Much of the DABA is based on the Island's extremely robust existing legislative framework in the insurance, funds and trust sectors. There are, for instance, requirements for certain risk management and compliance functions, and for an internal audit. In line with the Bermuda Insurance Act 1978, there is a physical presence requirement and a requirement to appoint a representative who has certain statutory duties to report matters to the BMA (e.g. whether there is a likelihood that the issuer may become insolvent).

Finally, the DABA grants the BMA a number of enforcement powers (e.g. a power to obtain information/reports or require the issuer to remove certain members of management) and also imposes various penalties for breach or non-compliance.

In short, the BMA believes that the DABA will be the leading global standard relating to virtual currency regulation, due in no small part to the sources from which it was derived—the OECD, the G20, FATF.

Conclusion

Bermuda is the world's leading offshore jurisdiction and wishes to remain so. It is also a business friendly and innovative jurisdiction, one which recognizes the risks within the general cryptocurrency space.

Companies in this space—particularly token issuers—are not shy of reasonable and credible regulation. With the new legislation and associated regulations being introduced, Bermuda is showing ingenuity, while it continues to adhere to prudentially sound international standards.

In the blockchain arena, Bermuda is leading the way and forging a unique and exciting “Bermuda Standard” which it hopes will become the global standard for ICOs, digital assets and virtual currencies.

AUTHOR:

CHRIS GARROD
DIRECTOR, HEAD OF BERMUDA BLOCKCHAIN & ICOS PRACTICE
chris.garrod@conyersdill.com
+1 441 299 4923

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

For further information please contact: media@conyersdill.com