

Article

Regulation of Digital Assets Issuances Should Foster Confidence

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Less than two years after the introduction of two fundamental pieces of fintech legislation, one of Bermuda's core digital asset laws has been revised to introduce the regulation of digital asset issuances.

The Digital Asset Issuance Act 2020 (DAIA), which became effective on 6 May 2020, replaces the 'Initial Coin Offering' (ICO) legislation of 2018¹, which amended Bermuda's company laws to allow the issuance of digital assets to the public. The ICO legislation required that offerings of digital coins or tokens be approved by the Minister of Finance, but once approved, offerings were not regulated on an ongoing basis. However, digital asset offerings became increasingly less attractive worldwide, as the lack of regulation of this space in the majority of countries meant ICOs and other forms of crypto offerings became associated with fraud and scams.

The DAIA aims to create a positive and safer environment for digital issuances. It provides for digital asset issuers to be regulated by the Bermuda Monetary Authority (BMA) in the same way that the Digital Asset Business Act 2018 (DABA) created a framework for the regulation of Bermuda-based digital asset businesses, including digital asset custodians and electronic exchanges. There is a high bar of minimum criteria to be able to register as a digital asset business with the BMA. Once established, there are stringent ongoing AML/ATF requirements along with head office requirements.

The fundamental underlying purpose of most digital asset offerings – crowdfunding using distributed asset technology (blockchain) – means they can play an important role in financing small and medium-sized enterprises and start-ups. Such entities cannot usually contemplate undertaking an expensive initial public offering, or other traditional methods of funding. While the regulation of digital asset issuances brings certain disadvantages (such as reduced speed to market and less flexibility), the increase in consumer and investor protection, greater legal certainty, and overall regulatory supervision are very attractive features for potential digital asset buyers, which could help foster confidence in this sector. The core of the DAIA legislation has been drafted with the protection of the average digital asset investor or purchaser in mind.

DAIA regulatory framework

Prospective digital asset issuers will need to go through an application process similar to that established by the DABA. An entity making an offering to the public (over 150 persons, rather than 35 persons which the ICO legislation required) must file a business plan for vetting by the BMA (rather than the Ministry of Finance). There are certain content requirements for the disclosure documents in order for potential investors to have as much information as possible. For example, the persons behind the issuance must be disclosed. An appropriate risk warning must appear in the issuance document clearly setting out any rights or risks in relation to the digital assets being offered. That would include detailed information regarding the investor's rights if the offering doesn't proceed and what substantial risks there may be which are reasonably foreseeable.

The application to the BMA must include a copy of the issuance document, along with the applicant's arrangements for the management of the offering. The BMA, of course, can request such other information it views as reasonably necessary in order for it to assess the application. The BMA has a dedicated Fintech team, who are happy to discuss applications prior to formal filing.

The BMA is further able to make rules relating to the issuance of the digital assets, and these could cover matters such as risk management, information technology and cybersecurity, financial reporting, KYC, due diligence, recording keeping, custody arrangements and any other matter which the BMA deems appropriate.

¹ Companies and Limited Liability Company (Initial Coin Offering) Amendment Act 2018, The Companies (Initial Coin Offering) Regulations 2018, and the Limited Liability Company (Initial Coin Offering) Regulations 2018

A digital copy of the signed issuance document, and whatever accompanying documents are required to comply with BMA rules, will all be published by the BMA. An electronic “communication facility” must also be kept open during the period of the offering for people to be able to post messages, see messages posted by others, and for potential investors to ask the issuer questions about the offering.

Other DAIA protections

From a high level perspective, the DAIA has embedded within it certain other protections which are provided to the BMA:

- a requirement to appoint a BMA-approved senior representative who must report certain events to the BMA (e.g. a possibility of insolvency, failure to comply with BMA conditions, material misstatements, etc.)
- material change approval requirements (such as if the entity plans to make a new offering of digital assets or wishes to make any change to its most recent issuance document)
- imposing a broad range of conditions, prohibitions or requirements such as removing officers, limiting the scope of the issuance and entering into any other class of transaction
- revoking the authorisation to act as a digital asset issuer; and
- winding up the issuer

There are also requirements to seek the BMA’s ‘no-objection’ in connection with changes to any 10% shareholder controller or majority shareholder (i.e. one with more than a 50% controlling interest in the entity) and there is a requirement to notify the BMA if there are changes of directors, senior executives, managers or officers of the entity.

In addition to the above, the BMA has been granted various disciplinary measures (e.g. injunctions, public censure and prohibition orders), rights to obtain information (including rights of entry, if need be) and investigation rights and powers to require documents.

Fintech-friendly and flexible

Bermuda has a very fintech-friendly Government, with a Fintech and Blockchain development team, a newly formed Economic Development Department and also several private sector fintech committees and organisations looking to help the jurisdiction develop this industry.

To facilitate formations, there is a Government of Bermuda Concierge Service which will assist entities seeking to incorporate and set up their operations on the Island. This includes assistance on matters such as registering with the Department of Social Insurance, payroll tax registration and any necessary work permit applications from the Department of Immigration.

The Government and its advisors remain keen to stay on top of the fintech environment and the industry it has already built, with an emphasis on quality over quantity. The aim of DAIA is to attract those digital asset issuers to Bermuda who wish to be regulated in a well-respected, blue-chip environment, which could help potential purchasers overcome their fears of investing in digital offerings. With the regulatory and legal infrastructure that has been carefully assembled, the jurisdiction offers something which many others don’t: fintech flexibility, an element very much required in this still nascent and ever evolving industry.

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