

FinTech and Cryptocurrencies

HM Government of Gibraltar has been working for a number of years in partnership with the Gibraltar Financial Services Commission ("GFSC") and industry to research and consult on the implementation of a regulatory framework for businesses using Distributed Ledger Technology (DLT) that do not fall within existing Financial Services or other regulatory frameworks.

Whilst other Jurisdictions have ignored, or sought to ban cryptocurrency and cryptocurrency related business, Gibraltar has taken the strategic view to take a proactive Regulatory approach to business models enabled by DLT.

Gibraltar's strategic vision, research and implementation of a principles based, robust yet flexible regime is being validated by the number of teams/projects that are choosing Gibraltar to establish themselves within a European regulated technology hub.

Distributed Ledger Technology (DLT)

Gibraltar's Financial Services (Distributed Ledger Technology Providers) Regulations 2017 (the "DLT Regulations"), came into force on 1 January 2018. The core principles underlying the DLT Regulations are explained here together with why DLT businesses should embrace regulation. The DLT Regulations mark a significant progressive milestone for the jurisdiction and are also a turning point for the crypto industry as a whole, which is largely unregulated and even banned in certain jurisdictions.

The DLT Regulations mark an initial phase in the regulation of the crypto industry in Gibraltar. It applies solely to businesses which operate in Gibraltar and use distributed ledger technology (DLT) for storing or transmitting value on behalf of third parties, and are not otherwise subject to licensing obligations under other laws. Initial coin offerings (commonly called ICOs) are not caught by this legislation. However given the increase in this form of raising funds for DLT related projects, the Gibraltar Financial Services Commission (the "GFSC") has announced plans to bring token sale activity within the regulatory scope in a second phase of regulation. As to DLT, the GFSC has the responsibility to issue licences under the DLT Regulations (the "DLT Licence") and ensure subsequent compliance with the said regulations. The GFSC encourages DLT businesses wishing to operate in Gibraltar to communicate and work with it so that the GFSC can understand the underlying business and make the DLT Licence application process as smooth as possible. When determining a DLT Licence application, the GFSC will adopt a discretionary approach that remains flexible by focusing on the nine core principles as listed in the DLT Regulations. The GFSC states that the primary purpose of these Regulations is to create a safe environment for DLT-related businesses to operate and innovate, while simultaneously protecting consumers and safeguarding Gibraltar's reputation as a trusted and stable global business hub. The principles-based approach was designed to provide a robust framework with an optimum level of flexibility that is required in such a fast-moving industry.

We are optimistic that the combination of the DLT Regulations and the open approach adopted by the GFSC will encourage the crypto industry to thrive and allow Gibraltar to become the "gold standard" jurisdiction for crypto businesses, in the same way it has been for the online gaming sector.

Initial Coin Offerings (ICOs)

Earlier this year the Government of Gibraltar has publically announced its intention to introduce regulations relating to, amongst other things, the promotion and sale of tokens in and from Gibraltar (the “ICO Regulations”) also. This regulatory regime shall complement and operate in parallel to the existing, recently established DLT Providers licensing framework, applicable to companies which transmit and store value belonging to third parties using distributed ledger technology. The Gibraltar Financial Services Commission (“GFSC”) has indicated that, whilst token sales themselves may not fall within the scope of the DLT Providers licensing framework, the ICO Regulations will provide rules and standards which an ICO launched or conducted from Gibraltar must comply with.

The offering and sale of tokens as a means of raising finance for the development, marketing and/or operation of a particular venture, raises various considerations. Some are critically important at the outset when structuring an ICO. The legal, regulatory and accounting characterisation of a token is highly dependent upon the nature of the rights and/or obligations attached to the token in question, as well as its intended use, value and velocity within the economy that is created following the development and operation of the ICO project. Given the myriad ways and methods in which such tokens can be issued and sold, and the almost infinite range of potential tokens which may be created, it is necessary, at the outset, to ensure that there is a proper analysis of the rights and/or obligations attached to the tokens and an assessment of the underlying token economics. This analysis would subsequently inform what the appropriate treatment of the token should be from a legal, regulatory, accounting and tax perspective.

Token sales are multi-jurisdictional, often global, events. It is therefore essential that any structure implemented draws on professional advice from multiple jurisdictions as may be relevant to the project in question.

Crypto Funds

The surge in prices of leading cryptocurrencies in quarter 2 and 3 of 2017 has also seen the emergence of demand for the setting up of crypto funds as institutional investors and other investors look to those with more experience and expertise to invest with.

Crypto funds however need to be carefully structured in order to appropriately protect investors. Otherwise, they can easily be used as a means to defraud unknowing investors with little or no chance of recovering their money.

The Gibraltar Funds & Investments Association (“GFIA”) has therefore recommended that all crypto funds, dealing with third party money, should be regulated by the GFSC as Experienced Investor Funds. EIFs are restricted to persons that fall within the definition of “experienced investor” which covers high net worth individuals, investment professionals and anyone who invests €100,000 (or €50,000 with professional advice). In addition, GFIA will be issuing an addendum to its existing funds Code of Conduct to tackle the specific problems thrown up by crypto funds. Since crypto EIFs are set up under the existing EIF regulations, they do not require a DLT licence.

EIFs require two local authorised EIF directors, an approved fund administrator and a local auditor. The fund will also require a bank account, crypto wallet(s) and an offering memorandum which meets the requirements of the EIF regulations. Crypto EIFs will also have tailored written policies covering storage, transmission and valuation of cryptos.

EIFs do not require pre-approval from the GFSC before launching. EIFs are launched based on a Gibraltar legal opinion provided that the required documentation is submitted to the GFSC within 10 days. This means that there is no regulatory downtime when considering speed to market.

EIFs are set up with ordinary shares and participation shares. Ordinary shares carry the voting rights with limited economic rights whilst participation shares carry the economic rights with limited voting rights. The fund promoters and/or fund managers will own the ordinary shares and the investors will be issued participation shares.

The crypto EIF will need to set out clearly the valuation methodology for its cryptos. This may be as simple as going by the price given by CoinMarketCap.com at a specific time and day (e.g. at 5pm CET on the last day of the month) as long as this is set out clearly in the fund's offering memorandum. The fund's administrator is responsible for calculating the net asset value per participation share.

Conclusion

Gibraltar has delivered on its strategic aim to be at the forefront of Regulatory innovation with the introduction of the DLT framework for blockchain enabled businesses who want to hold themselves accountable to an independent Regulatory body, and who want to operate under best practices and obligations (commonplace in the Financial Services space) such as for example AML/KYC, fit and proper senior management, risk and governance frameworks, financial/non-financial resources, protection of customer assets and fair treatment of customers.

April 2018 will see the second phase in that Regulatory innovation with the release of the draft legislation covering Tokens (ICOs).

In developing the Regulatory framework and in providing the legal, accounting, structuring and taxation advisory support services to teams/projects in the Fintech – DLT/ICO space, the Gibraltar professional services infrastructure is highly developed to assist businesses define and execute their road maps.