

STROOCK SPECIAL BULLETIN

Bermuda is Quickly Gaining Favor as a Jurisdiction-of-Choice for Digital Assets

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Bermuda is well known as a global center for financial services as the Island operates the largest reinsurance market in the world. Now, Bermuda is aggressively diving into the FinTech sector with a clear objective: to establish the Island as the jurisdiction-of-choice for FinTech entrepreneurs and its new regulatory framework as the universal standard for initial coin offerings (“ICOs”), digital assets and virtual currencies. By doing so, the Hon. E. David Burt, JP, MP (Bermuda’s Premier and Minister of Finance) hopes to diversify Bermuda’s economy and encourage new development—monetary, educational and cultural—in the Island.

If recent developments are any indication, Bermuda is perhaps well on the path to quickly becoming the global leader for the issuance of digital assets. When discussing international interest in Bermuda’s initiative, the Premier stated, “Bermuda’s leadership in the development of a FinTech industry supported by a sound regulatory base is attracting the attention of the world. This Government’s determination to produce the right framework for growth in this area has set a high standard.”

I. Bermuda’s Innovative Digital Assets Regulatory Framework

While some nations have inhibited the development of digital assets (*e.g.*, China and South Korea), most others have not yet passed legislation germane to the asset class. Bermuda in contrast seeks to set the market, implementing a comprehensive and prudential regulatory framework designed to create a supportive business environment that fosters development. The government has collaborated with a partnership of regulators, external consultants and other private-sector representatives to develop a best-in-class system that will serve as the standard for other jurisdictions (the “Bermuda Standard”).

Bermuda has tabled two bills that it believes will establish the necessary regulatory framework to guide its initiative. The proposed legislation governs two distinct categories of business:

1. issuers who launch ICOs for their own crowdfunding purposes, which will be regulated by amendments to the existing Companies Act 1981 and Limited Liability Company Act 2016 (collectively, the “ICO Act”), and by the Registrar of Companies (“ROC”); and

2. issuers of virtual currencies and operators of digital asset exchanges, as well as individuals who provide services related to digital assets, which will be regulated under the new Digital Asset Business Act 2018 (“DABA”) and by the Bermuda Monetary Authority (“BMA”).

Bermuda seeks to embrace the potential afforded by digital assets, but not at the expense of tarnishing its pristine international finance reputation. The Blockchain Task Force,¹ comprised of government, industry, legal and technology professionals, collectively drafted these bills to set reasonable and credible regulation. The task force also has issued additional regulations and guidance on critical topics, such as cyber security and prudential business standards. Bermuda recognizes that digital assets present significant risks that require robust anti-money laundering (“AML”) and anti-terrorism financing (“ATF”) regulations, but believes that the ICO Act and DABA are suitable safeguards.

II. The Initial Coin Offering Act

The ICO Act passed through Parliament in May 2018 and regulates offerings of “digital assets,” which include various types of digital coins and tokens (*i.e.*, equity, security and utility) that are issued as ICOs. Specifically, the ICO Act defines “digital assets” as:

[A]nything that exists in binary format and comes with the right to use it and includes a digital representation of value that—

- (a) is used as a medium of exchange, unit of account, or store of value and is not legal tender, whether or not denominated in legal tender;
- (b) is intended to represent assets such as debt or equity in the promoter;
- (c) is otherwise intended to represent any assets or rights associated with such assets; or
- (d) is intended to provide access to an application or service or product by means of blockchain[.]

ICOs are a “restricted activity” that requires the consent of the Minister of Finance prior to a public offering, which is a sale to more than 35 investors. The ICO Act is silent as to private sales to 35 investors or fewer. Assisted by the FinTech Advisory Committee, the Minister of Finance will review each proposed ICO to ensure that the issuer satisfies the base criteria that the issuer purports in its offering document, which often is the issuer’s white paper. Once consent is granted, the issuer must file its ICO offering document (subject to certain exemptions, including, but not limited to, if the digital assets are listed on an appointed stock or digital asset exchange) with the ROC.

With respect to timing, the issuer should be able to incorporate within the typical 48 hour period using Bermuda’s standard incorporation procedures, assuming all know-your-customer (KYC), AML and ATF issues have been addressed from a due diligence perspective. However, because express consent from the Minister of Finance is a precondition to issuance, it is advisable that the issuer file its ICO offering document with the Minister of Finance as early as possible.

¹ The Government of Bermuda’s Blockchain Task Force aims to advance the regulatory environment and develop Bermuda as a destination for utility tokens, tokenized securities, cryptocurrencies and ICOs. The task force includes two working groups: (1) the Blockchain Legal and Regulatory Working Group, which is chaired by Ms. Lydia Dickens, the Director of the Business Development Unit in the Ministry of Economic Development and Tourism; and (2) the Blockchain Business Development Working Group, which is chaired by Mr. John Narroay, a veteran technology entrepreneur and founder of technology-based ventures Saker Aircraft and Midori Ventures. The working groups serve under the direction of the Minister of National Security, the Hon. Wayne M. Caines, JP, MP.

The ICO Act provides that the offering document must include at minimum:

- (a) the name and the address of the registered office or principal office of the promoters;
- (b) the name, description and titles of the managers of the promoter;
- (c) the business or proposed business of the limited liability company;
- (d) a description of the project, the proposed timeline for the project including any proposed project phases and milestones;
- (e) the amount of money equivalent (in Bermuda dollars) that the [ICO] is intended to raise;
- (f) the allocation of the amount of money equivalent (in Bermuda dollars) intended to be raised amongst purchasers of digital assets at each point at which digital assets will be offered for purchase;
- (g) any rights or restrictions on the digital assets that are being offered;
- (h) the date and time of the opening and closing of the offering of digital assets;
- (i) the general [ICO] risk warning referred to in section 34F [and section 85F];
- (j) a statement as to how personal information will be used.

Many provisions of the ICO Act are similar to the Bermuda statutes regulating initial public offerings. For example, the requirement to file the ICO offering document with the ROC and to submit updates of same to the ROC on a going forward basis. The ICO Act also requires issuers to include a general risk statement identifying the potential ramifications to investors should the ICO fail. In addition, the ICO Act requires issuers to collect, verify and maintain investor identity information in accordance with AML and ATF laws. Finally, the ICO Act contains criminal

offenses and imposes civil penalties of up to BD\$250,000 for making materially untrue statements in the ICO offering document.

III. The Digital Asset Business Act

DABA will become operative upon public notice being published in the official Gazette, which is expected to occur any day. DABA regulates “digital asset business” conducted in or from Bermuda, which is defined under Section 2(2) as follows:

Subject to section 4(5), in [DABA], “digital asset business” means the business of providing any or all of the following digital asset business activities to the general public—

- (a) issuing, selling or redeeming virtual coins, tokens or any other form of digital asset;
- (b) operating as a payment service provider business utilizing digital assets which includes the provision of services for the transfer of funds;
- (c) operating as an electronic exchange;
- (d) providing custodial wallet services;
- (e) operating as a digital asset services vendor.

To be clear, companies issuing ICOs as a funding mechanism for their own business are not regulated under DABA, as such activities are within the scope of the ICO Act. However, companies that issue ICOs for others will be regulated under DABA.

Before engaging in digital asset business, one must obtain a license in one of two classes specified in Sections 12(3)(a)-(b), unless exempt as provided in an exemption order issued pursuant to Section 11. Applications must be made to the BMA for either of the following digital asset business licenses:

- Class F – The applicant shall be licensed to provide any or all of the digital asset business activities.
- Class M – The applicant shall be licensed to provide any or all of the digital asset business activities for a defined period determined by the BMA, which may be extended upon application to the BMA.

The Class F license is a full digital asset business license, whereas the Class M license is a “sandbox” license that allows startups to experiment with new products or services for a limited period of time. The tiered licensing scheme bolsters Bermuda’s initiative to create a supportive business environment that attracts FinTech innovation to the Island while simultaneously ensuring customer protection. The BMA may impose limitations as necessary with respect to the nature and scale of the business permitted under either license, which can include limits on the scope of the digital asset business activity or the manner of operating the digital asset business.

Those applying for either the Class F or Class M license must submit the following information to the BMA at the time of application under Section 12(6):

- (a) a business plan setting out the nature and scale of the digital asset business activity which is to be carried on by the applicant;
- (b) particulars of the applicant’s arrangements for the management of the business;
- (c) policies and procedures to be adopted by the applicant to meet the obligations under [DABA] and the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008;
- (d) such other information and documents as the [BMA] may reasonably require for the purpose of determining the application; and

- (e) an application fee which shall be an amount determined by the Authority commensurate to the nature, scale and complexity of the digital asset business to be carried on by the undertaking and as may be prescribed under the Bermuda Monetary Authority Act 1969.

DABA’s origins lie primarily in Bermuda’s extensive legislative framework for the insurance, funds and trust sectors. Similarities include, but are not limited to, risk management and compliance standards and the requirement of an internal audit. As with the Bermuda Insurance Act 1978, DABA requires that a licensee maintain a head office on the Island from which the digital asset business will be directed and managed. The licensee also must appoint a representative who has a statutory duty to report sensitive developments to the BMA, such as the potential of issuer insolvency.

DABA grants the BMA certain enforcement powers, which include the authority to demand information or reports from a licensee, as well as to remove members of a licensee’s management team. DABA also contains criminal offenses and imposes civil penalties of up to BD\$10 million for non-compliance.

IV. Bermuda’s Initiative Moving Forward

This year Bermuda will adopt additional regulations and issue further guidance to support the development of digital assets and its broader FinTech initiative. These endeavors should solidify the Island as the jurisdiction-of-choice for international FinTech entrepreneurs and confirm the Bermuda Standard as best-in-class.

This summer Bermuda will launch a national electronic identification ledger (E-ID) using blockchain technology. E-ID will provide a single platform that licensees can use to efficiently comply with KYC, AML and ATF rules. E-ID is designed to comply with international rules and regulations, such as the Personal Information Protection Act in Bermuda and the General Data

Protection Regulation in Europe. E-ID also will enable individuals to control third-party access to their data by allowing them to grant permissions for specific data for a defined period of time. In addition, the use of blockchain should provide increased efficiencies through the elimination of duplicative efforts, the aggregation of verified data and instant customer authentication.

Bermuda's Blockchain Task Force has announced that later this year it will establish a legal and regulatory framework for virtual currency exchanges. Reportedly, this initiative is scheduled to become operative in September 2018.

News of Bermuda's business-friendly regulatory environment is spreading quickly, and, not surprisingly, FinTech companies are moving to the Island. In April, the Hon. E. David Burt signed a memorandum of understanding (MOU) with Binance Group, operator of the world's largest cryptocurrency exchange and leader in digital exchange development and FinTech, with a market capitalization of US\$1.3 billion. In May, the Premier signed a MOU with Shyft Network Inc., which provides blockchain-based identification solutions for KYC and AML-compliant data transfers.

In June, the Premier signed a MOU establishing a strategic partnership with interests from the Republic of Korea. The MOU involves B-Seed Partners (Republic of Korea), FinHigh Capital (United States) and BFS Holdings Ltd. (Bermuda), as partners in a new Bermudian joint venture, Bermuda FinTech Accelerator ("BFA"). BFA plans to deploy a developed pipeline of fully-funded FinTech projects, including token sales, and cutting-edge FinTech technology that is not yet available on the Island, which will benefit the community through efficiencies, the creation of jobs and educational opportunities. Also in June, Arbitrade Ltd. announced its intent to establish its global headquarters in Bermuda with plans to launch its own ICO and digital asset exchange in August or September 2018.

Having been a part in some of these initiatives leading to the MOUs, we agree that, at the moment, Bermuda provides an attractive alternative to other jurisdictions where ICOs are allowed and accepted. Whether or not Bermuda will become a leading jurisdiction will depend, in part, on the rate and volume of ICOs, the establishment of digital asset exchanges to create liquidity, the development of digital asset management businesses, the extent to which digital assets are linked to fiat, and, ultimately,

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