



PARLIAMENTARY SECRETARIAT FOR FINANCIAL SERVICES,
DIGITAL ECONOMY AND INNOVATION
OFFICE OF THE PRIME MINISTER

MALTA A LEADER IN DLT REGULATION



The establishment of the
Malta Digital Innovation Authority;
the Framework for the Certification
of Distributed Ledger Technology
Platforms and Related
Service Providers;
and a Virtual Currency Act.

Responding to this Consultation Document

The Parliamentary Secretary for Financial Services, Digital Economy and Innovation within the Office of the Prime Minister invites responses to this consultation document on the establishment of an Authority to be known as the Malta Digital Innovation Authority and the framework for the certification of Distributed Ledger Technology Platforms and related service providers.

Please note that the responses must reach this office by Friday 9th March, 2018.

Who should read this Consultation Document?

This document will be of interest to all stakeholders involved in the digital technology sector including prospective promoters, developers, administrators and auditors of Distributed Ledger Technology platforms, issuers of ICOs and brokers, exchanges and other intermediaries dealing in virtual currencies and similar assets. It is also primarily of interest to other national competent authorities and regulated entities that make extensive use of Distributed Ledger Technology in their business.

This Consultation document is also important for trade associations and industry bodies.

This Consultation Document should be read in conjunction with the Discussion Paper on Initial Coin Offerings, Virtual Currencies and related Service Providers issued by the MFSA on the 30th November 2017.

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Acronyms

DLT	Distributed Ledger Technology including Blockchain.
DLT Platforms	Distributed Ledger Technology Platforms.
ESMA	European Securities and Market Authority.
ICO	Initial Coin Offer.
JCB	Joint Co-ordination Board.
MDIA	Malta Digital Innovation Authority.
MDIA Bill	A Bill to provide for the establishment of an Authority to be known as the Malta Digital Innovation Authority.
MITA	Malta Information Technology Agency.
MCA	Malta Communications Authority.
MGA	Malta Gaming Authority.
MFSA	Malta Financial Services Authority.
MCCAA	Malta Competition and Consumer Affairs Authority.
Minister	The Minister responsible for Digital Economy.
NCA	National Competent Authority.
NTEC	National Technology Ethics Committee.
TAS Bill	A Bill to provide the framework for the registration of Auditors and Administrators of DLT Platforms and the certification of such platforms.
Technology Arrangements	DLT Platforms and related smart contracts.
Technology Service Providers	Auditors and Administrators of Technology Arrangements and related smart contracts.
Tribunal	The Administrative Review Tribunal.
VC	Virtual Currencies.
VC Bill	A Bill that will provide the framework for the regulation of ICOs and intermediation of virtual currencies. The intermediaries subject to the VC Bill include brokers, exchanges, wallet providers, asset managers, investment advisors and market makers dealing in VCs.

FOREWARD BY PARLIAMENTARY SECRETARY SILVIO SCHEMBRI



Malta harbours a deep interest in the fast growing sectors of digital technologies in general and DLT in particular. We see great opportunities in these areas and are keen to position Malta as the natural destination for businesses that operate in this space.

During the last few months, as a Government, we have engaged extensively with private parties across various sectors, both local and international, as well as with lead regulators in order to identify the changes in our legislative and administrative framework required for Malta to become a leading jurisdiction in this area.

We are proposing a framework that conceptualises the creation of a new Digital Innovation Authority, the voluntary registration of Technology Service Providers and the certification of DLT Platforms and related smart contracts such as Technology Arrangements. The framework also includes a regime, developed by the MFSA, for the approval of ICOs and the regulation of certain service providers dealing in VCs including brokers, exchanges, wallet providers, asset managers, investment advisors and market makers. The Discussion Paper on Initial Coin Offerings, Virtual Currencies and related Service Providers issued by the MFSA on the 30th November 2017 sets out the proposed framework in this respect. The MFSA will in the coming weeks be issuing its feedback to the responses received on this discussion paper.

The proposed framework will offer legal certainty in a space that is currently unregulated and touches upon a number of issues including types of authorisations, legal personality, and the applicability of law on smart contracts.

It is hoped that this document offers the opportunity to deepen thoughts on how Malta can help in developing this area through legal design and take its place among the supporters of innovation for the benefit of our society.

An aerial night view of a harbor in Malta, showing modern buildings, a curved road, and several boats in the water. The scene is illuminated by city lights and a blue-tinted sky.

MALTA A HUB FOR DIGITAL TECHNOLOGY INNOVATION



Throughout the years, Malta has managed to distinguish itself across a range of industries, ranging from financial, corporate and fiduciary services and other knowledge-based sectors to high-end manufacturing, from microchip, pharmaceuticals and maritime services to aircraft maintenance.

During the past few years, the Maltese economy continued on its expansion path. Economic growth is well above the Euro-Area average. Employment figures have moved consistently up with the introduction of several policy initiatives that make work pay. The demand for labour increased significantly as established sectors such as financial services and online gaming consolidated their operations in Malta.

These achievements were the result of Malta's constant investments in infrastructure and its human resources. It is a well-established fact that the high level of education and a skilled workforce have been pivotal in helping the development of Malta as a centre of excellence and made it possible to position itself as an international hub for business.

An additional factor that is central to Malta's success is the presence of a robust regulatory support infrastructure that offers access to a full range of services and products whilst offering certainty. For Malta, to consolidate its present position and develop further its potential in becoming an attractive alternative to the world's main international financial centres, its legislative framework and regulatory bodies, need to continue evolving.

The proliferation of new and emerging technologies will have serious impact on the majority of industries such as financial services, education and health, logistics, transport and public administration as well as others such as online gaming and intellectual property. Malta needs to lead in this area by being proactive, open to business, attracting entrepreneurs and investors from all over the world. In being so, Malta can be transformed into an international hub for digital technology innovation.

The background features a hand holding a smartphone, with a cityscape visible through the screen. Overlaid on this are several circular icons connected by a network of lines. The icons include: a cloud, an envelope, a laptop, a database cylinder, a hierarchical flowchart, and a speech bubble. The text 'INTRODUCING DIGITAL TECHNOLOGY' is centered in blue, with 'DIGITAL' in a larger, bold font.

INTRODUCING **DIGITAL** TECHNOLOGY



Digital technology has immensely changed our society: how it works, how it communicates, and how it does business. The transformation continues as digital technology evolves further.

We are now witnessing the proliferation of DLT, or as most commonly known, blockchain. New uses and applications are emerging on a daily basis.

Two major technologies underpin DLT. The first is a private key, which is a form of signature that provides ownership of a transaction and provides evidence that it comes from a legitimate source. The second factor is the presence of an extensive network whose primary purpose is to validate the transactions and by that confirm they have all witnessed the same thing at the same time. Combining the security key with the verification from the network allows a safe and quick flow of transactions.

DLT has several interesting properties including irreversibility of transactions meaning that once the transaction has been shared and authenticated nobody can reverse it. With Security as another important property, the extremely strong cryptography prevents anyone from being able to access the code and the signature.

In a nutshell, DLT is made up of a decentralized network facilitating and verifying transactions. Everyone in the network can see this shared transaction ledger, but there is no single point of failure from which records or digital assets can be hacked or corrupted. DLT has applications across every kind of digital record and transaction, and we are already beginning to see major industries leaning into the shift.

What is blockchain?



A digital ledger that keeps a record of all transactions taking place on a peer-to-peer network



All information transferred via blockchain is encrypted and every occurrence recorded, meaning it cannot be altered



It is decentralised, so there's no need for any central, certifying authority



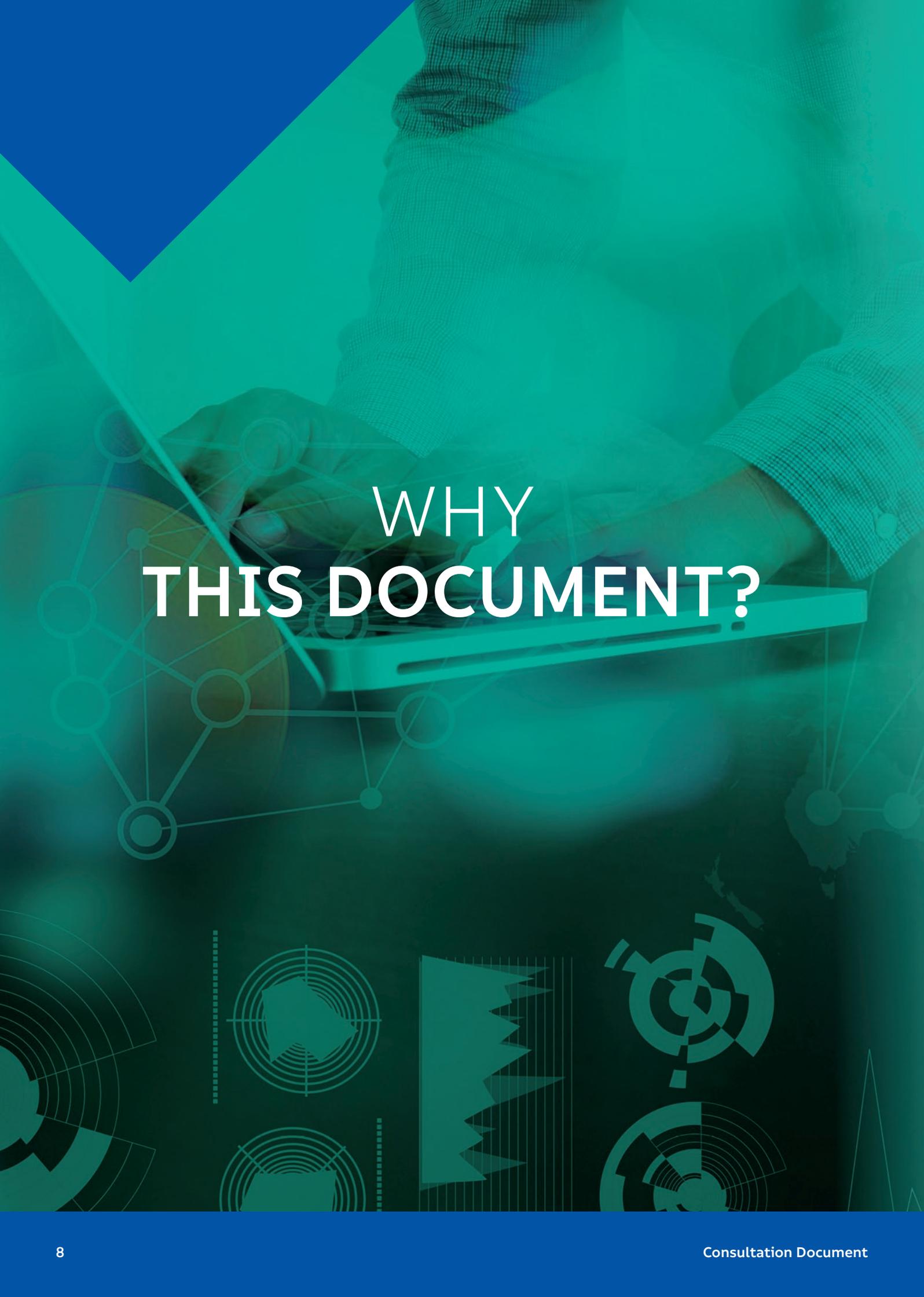
Encrypted information can be shared across multiple providers without risk of a privacy breach



It can be used for much more than the transfer of currency; contracts, records and other kinds of data can be shared

The uses of DLT are almost infinite. They range from financial services where a growing number of financial services firms are using this technology to introduce innovations, such as smart bonds and smart contracts to asset management where each party involved in a transaction, such as a broker, a custodian, a clearer keep their own records independent from one another. This creates significant inefficiencies and room for error. DLT reduces error by encrypting the records. At the same time, the ledger simplifies the process, while cancelling the need for intermediaries. Other applications include voting where DLTs are used to permit voters to vote via smartphones, resulting in immediate verifiable results, and healthcare where patients' encrypted health information could be shared with multiple providers without the risk of privacy breaches.





WHY THIS DOCUMENT?

The Maltese Government has over the past months been actively working on the development of a framework to oversee the uses of DLT and related service providers. A National Blockchain Strategy Taskforce was set up to advise government in this regard.

Concurrently, on the 23rd October 2017, the MFSA issued its first consultation document on a Proposed Regulatory Framework for Collective Investment Schemes investing in VCs. This consultation was concluded and the MFSA proceeded with the issue of a Feedback Statement on the 22nd January 2018 summarising the response received from stakeholders and setting out MFSA's position. MFSA published the supplementary conditions applicable to Professional Investor Funds investing in VCs on the 29th January 2018. The Authority is now considering whether the published supplementary conditions should also be implemented within the context of regulated alternative investment funds and notified alternative investment funds.

On the 30th November 2017, MFSA published a Discussion Paper on Initial Coin Offerings, Virtual Currencies and related Service Providers. This document followed the general principles set out in a statement issued by ESMA on the 13th November 2017. As explained in the Discussion Paper, whilst certain ICOs, VCs and related activities could fall within the scope of existing financial services legislation, others are likely to fall outside scope and would hence be unregulated. The purpose of the Discussion Paper was to present to stakeholders a proposed policy which will be adopted by the MFSA for the creation of a framework relating to ICOs and the provision of certain services (namely intermediaries that act as brokers, exchanges, wallet providers, asset managers, investment advisors and market makers) in relation to VCs that currently fall outside of existing financial regulation.

The consultation period for the Discussion Paper closed on the 18th January 2018 and the Government is pleased to be informed that the Authority is currently assessing the feedback received from over 40 industry participants and interested parties.

The discussions between the Government and the MFSA on the proposed regulatory framework relating to the provision of certain services in relation to VCs, including ICOs, is on-going. This consultation document provides a high-level indication on the way forward determined by the MFSA and agreed with the Government, after taking into account the feedback received by the MFSA on the Discussion Paper.

This document presents a conceptual framework through which DLT Platforms can be subject to certification in Malta. This framework also takes into account the need to oversee the principal service providers to DLT Platforms. Separately through the MFSA, the framework extends to issuers of ICOs and certain service providers dealing in virtual currencies.

3.1 Proposed legislative developments

This consultation document relates to a legislative approach involving the promulgation into law of three proposed pieces of legislation namely, the MDIA Bill, the TAS Bill and the VC Bill.

The MDIA Bill will provide for the establishment of an Authority to be known as the Malta Digital Innovation Authority.

The TAS Bill will set out the regime for the registration of Technology Service Providers and the certification of Technology Arrangements.

The VC Bill will set out the framework for ICOs and the regulatory regime on to the provision of certain services in relation to VCs. The intermediaries subject to the VC Bill include brokers, exchanges, wallet providers, asset managers, investment advisors and market makers dealing in VCs.



3.2 The MDIA Bill and the TAS Bill

The establishment of the MDIA, including the introduction of a regime for registration of Technology Service Providers and the certification of Technology Arrangements, can be of benefit to the economic and social development of Malta. It can also provide an opportunity for further development of existing sectors and the creation of new ones, with a good potential for additional foreign direct investment in Malta, the transfer of know-how and related skills and new specialist opportunities for our community.

The proliferation of new technology arrangements will also have a serious impact on the other major industries in Malta such as the financial services sector, education and health, logistics, transport and public administration as well as on others such as the online gaming sector.

The MDIA will have the opportunity to focus on innovative technology arrangements and their uses such that Malta can take the greatest advantage of new technology arrangements while at the same time protect the public interest.

The wide uses of innovative technology arrangements may in some instances bring about an overlap between the role of the MDIA and the supervisory role of other NCAs. As a result the Bill will constitute the new “Joint Co-Ordination Board” whose responsibility shall be the fostering of effective cooperation between the MDIA and the other NCAs, in the area of technology uses. The JCB will not interfere or diminish the autonomy or supervisory role of NCAs.

The MDIA Bill will focus on the establishment of the MDIA and its internal governance arrangements including the composition of the Board of Governance, the employees and officers of the MDIA, conduct of its affairs and relevant financial provisions.

The MDIA Bill will set out in detail the powers granted to the MDIA and dispute resolution mechanisms through the Administrative Review Tribunal. The MDIA Bill will also cater for co-operation between the MDIA and other NCAs.

The TAS Bill will set out the framework applicable to

- Technology Arrangements;
- auditors of Technology Arrangements related smart contracts; and
- administrators of Technology Arrangements.

and will also specify certain Private Law issues relating to Technology Arrangements.

An overhead, top-down view of three people working at a large wooden desk. The scene is bathed in a warm, orange-red light. On the left, a man in a dark jacket is typing on a laptop. In the center, another man in a dark suit is leaning over the desk, using a calculator. On the right, a woman in a light-colored top is also typing on a laptop. The desk is cluttered with various office supplies, including a spiral notebook, a pair of glasses, a small container with pens and pencils, and a ball of string. The overall atmosphere is one of focused, collaborative work.

THE MALTA DIGITAL INNOVATION AUTHORITY



4.1 Constitution of MDIA and proposed Governance arrangements

The MDIA Bill will establish the Malta Digital Innovation Authority. It is proposed that the MDIA will be a body corporate having a distinct legal personality and shall be capable of entering into contracts, of acquiring, holding and disposing of any kind of property for the purposes of its functions, of suing and being sued, and of doing all such things and entering into all such transactions as are incidental or conducive to the exercise or performance of its functions including the lending or borrowing of money. The legal and judicial representation of the MDIA shall vest in the Chairman.

The MDIA Bill will provide that the affairs and business of the MDIA shall be carried out by a Board of Governors composed of a Chairman and a maximum of eight other members. The members of the Board of Governors including the Chairman shall be selected by the Minister responsible for Digital Economy. The Board of Governors will be empowered to delegate the executive conduct of the MDIA, to any officer or officers of the Authority.

The Board of Governors shall meet as often as necessary but in any event at least once a month.

The MDIA is being set up to achieve the following objectives and policies:

- a. to promote governmental policies that favour the development of Malta as a centre of excellence for technological innovation and in particular deployment of Digital Ledger Technology, including its adoption in systems of public administration by the Government;
- b. to foster, promote and facilitate the advancement and utilisation of digital ledger technology and its design and uses;
- c. to promote education on ethical standards and legitimate exploitation, use and creation of technology in particular digital ledger technology;
- d. to safeguard, maintain and protect the reputation of Malta taking into account Malta's international commitments and to collaborate with other states and international organisations in implementing the best standards in the sector;
- e. to protect users and consumers, in particular when either directly or indirectly they will interface or use digital ledger technology to ensure adequate standards aimed at meeting their legitimate expectations;
- f. to harmonise practices and where applicable facilitate the adoption of standards in the digital ledger technology sector in Malta in line with international norms and with those of the European Union in particular;
- g. to assist the competent data protection authorities in safeguarding the data protection rights of data subjects and assist other competent authorities for the protection of vulnerable persons and the promotion of competition and choice;
- h. to promote and if required enforce ethical and legitimate criteria in the design and use of digital ledger technology, and any application, software or derivative nascent from it or intrinsically part of it or connected to it, as well as quality of service and security;
- i. to promote transparency and auditability in the use of digital ledger technology, and any application, software or derivative nascent from it or intrinsically part of it or connected to it;
- j. to promote legal certainty in the application of laws, in a national and cross-border context, and legal principles.

The MDIA shall be responsible for the certification of Technology Arrangements and the registration of Technology Service Providers, as the "competent authority" in terms of the proposed TAS Bill. The MDIA shall act independently and shall not seek or take instructions from any other body or person. The Minister responsible for Digital Economy may, in relation to matters that affect the public interest, give to MDIA directions in writing on the policy to be followed in the carrying out of the functions vested in the MDIA.

The MDIA Bill shall afford the MDIA extensive powers in order to be able to discharge its regulatory obligations in particular the power to monitor and supervise the technology in Malta.

The MDIA may certify or refuse to certify a Technology Arrangement and may register or refuse to register a Technology Service Provider. It may also cancel, suspend or vary the certification issued in

favour of a Technology Arrangement or the registration of a Technology Service Provider. The MDIA shall have the power to request information from several persons that it may require to be able to discharge its duties. The MDIA may also appoint inspectors, issue directives, exercise a right of entry, impose administrative penalties and issue a public statement as to a person's misconduct.

Any decisions taken by the MDIA in the discharge of its duties will be subject to appeal before the Tribunal. An appeal from a decision of the MDIA shall be made with the Secretary of the Tribunal within twenty (20) days from the date on which the said decision has been notified. Any decision of the MDIA that is pending an appeal whether before a Tribunal or the Court of Appeal, shall stand and shall be adhered to by all the parties to whom the decision applies. Notwithstanding the above, the Tribunal or the Court of Appeal, as the case may be, may, on the application of a party to the appeal, suspend in whole or in part the decision which is the subject of the appeal pending the final determination of the appeal.

The MDIA Bill also provides for the establishment of a JCB and the NTEC.

4.2 The Joint Co-ordination Board

The MDIA Bill shall establish the JCB. The scope of JCB is to ensure effective cooperation between the MDIA and other NCAs in the area of technology uses. The JCB shall also have the following functions:

- i. to give advice about whether and how an NCA or public institution should act in respect of a Technology Arrangement, where the issue appears to the JCB to be relevant to the development of technology uses and related services and arrangements in Malta;
- ii. to act as the medium to establish national standards when asked to do so by any NCA with reference to Technology Arrangements and their uses, and in particular to adopt codes of best practices for NCAs to benchmark their requirements against in carrying out its functions;

and any such recommendation, advice or assessment made by the Board shall be taken into consideration by a public authority or public institution in Malta in the execution of its functions.

4.3 The National Technology Ethics Committee

The MDIA Bill will also establish the National Technology Ethics Committee. The NTEC shall ensure that the proper standards of ethics are reflected in the use of relevant Technology Arrangements and to guide other NCAs in Malta.

The NTEC will be mandated to develop guidance on the ethical standards which could be adopted in relation to the design and use of technology and innovation. It shall also assess and establish ethical standards for the purposes and uses of Technology Arrangements to ensure that Technology Arrangements may not be designed to undermine the ethical standards expected to operate within a democratic state.

It is proposed that the NTEC be composed of not less than 10 and not more than 15 persons, having expertise in the broad areas of society so as to reflect practical experiences in relation to law and law enforcement, science, religion, security services, supervision of ethical rules in particular professions or sectors, as well as academics on history, education, philosophy, ethics, human rights, religion, law, and related subjects.



FRAMEWORK APPLICABLE TO TECHNOLOGY ARRANGEMENTS AND TECHNOLOGY SERVICE PROVIDERS

It is being proposed that the MDIA will act as lead NCA of all Technology Arrangements and Technology Service Providers in terms of the proposed TAS Bill. As a result the MDIA will be the national competent authority responsible for the certification of Technology Arrangements and the registration of Technology Service Providers.

5.1 Technology Arrangements

It is proposed that the TAS Bill will initially capture DLT Platforms and related smart contracts only. These platforms and arrangements will fall under the definition of Technology Arrangements specified in the Bill.

The Government may in the future extend the definition of Technology Arrangements to include other platforms and arrangements, such as those relating to artificial intelligence, with a view to extend the scope of the TAS Bill.

It is being proposed that any person will be able, on a voluntary basis, to request the MDIA to certify a Technology Arrangement. One of the conditions that the MDIA will require, in order to be able to consider this request, is that the Technology Arrangement has an Administrator that is registered with the MDIA (see 5.2 below). It is anticipated that the MDIA will undertake a principles based review and will assess the proposed Technology Arrangement's from various perspectives such as compliance with applicable laws, integrity and security. It is expected that the list of qualities that Technology Arrangements applying for certification will be required to possess and which will be assessed as part of the certification process will be formulated by the MDIA once this is constituted.

One of the major benefits of DLT is the possibility of integrating smart contracts which are self-executing without the need of additional third party intervention. The current legislative framework does not contemplate having contracts in 'smart' format and therefore the intention is to provide a degree of legal certainty to smart contracts. In the same way that Article 9 of the Electronic Commerce Act (Chapter 426 of the laws of Malta) provides that a contract shall not be invalid simply because it is in 'electronic' form, it is proposed that a similar provision will be introduced to ensure that a contract is not invalidated simply because of its 'smart' format.

5.2 Technology Service Providers

The proposed MDIA Bill identifies the following key service providers to a Technology Arrangement.

- Auditors of Technology Arrangements; and
- Administrators of Technology Arrangements.

The Auditor of a Technology Arrangement is the person who reviews and assesses the Technology Arrangement against a number of pre-determined criteria.

The Administrator of a Technology Arrangement is the person, under whatever name designated, who assumes responsibility to manage or otherwise control the operation of the whole or part of any Technology Arrangement.

It is being proposed that Technology Service Providers who provide services:

- in relation to any DLT Platform which is certificated by the MDIA;
- in or from Malta; or
- through Maltese legal persons; or
- in such other cases as the Minister responsible for Digital Economy may prescribe,

may seek registration with the MDIA.

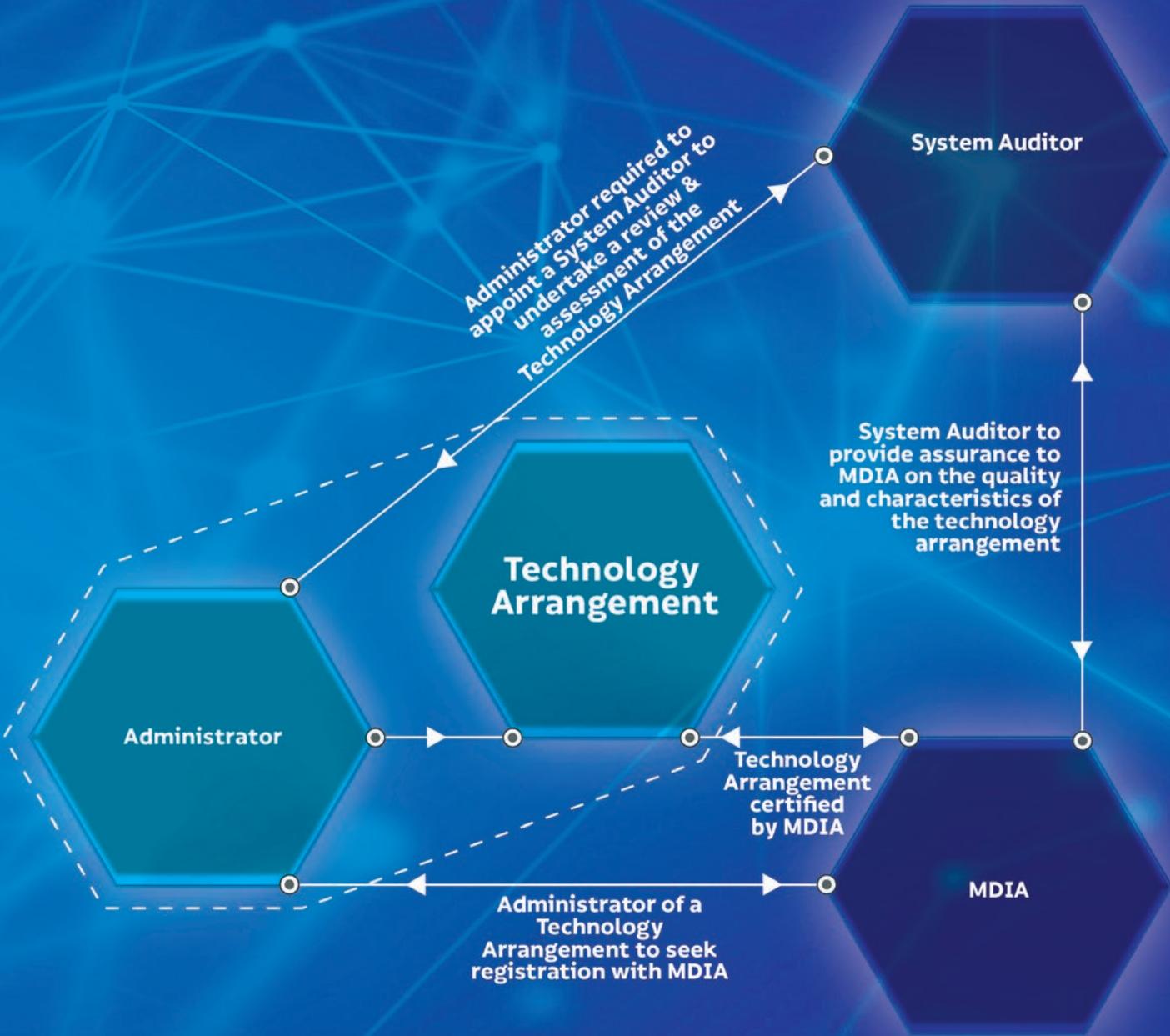
The registration of Technology Service Providers with the MDIA in terms of the TAS Bill will be voluntary. It is anticipated that the MDIA will be able to entertain requests for registration as a Technology Service Provider received from (a) a body corporate, unincorporated body or association formed in accordance with or existing under the laws of Malta, and (b) a body corporate, unincorporated body or association formed in accordance with or existing under the laws of another EEA Member State to the extent that it provides services in Malta.

The MDIA will apply a fitness and properness assessment on prospective Technology Service Providers seeking registration with MDIA. Technology Service Providers registered with MDIA will be required to adhere to ongoing registration requirements.

5.3 Legal Personality of Technology Arrangements

Whilst some Technology Arrangements are owned by a corporate structure, other Technology Arrangements may not have such an ownership structure. This could result in the possibility of transacting on and with the Technology Arrangement without a proper 'legal person' as counterparty. The proposed TAS Bill will try to provide a solution to such a scenario and it is being proposed that certain Technology Arrangements will be able to register with the Registrar for Legal Persons in Malta and acquire legal personality upon satisfaction of a number of requirements.

5.4 Practical Application 1:
Certification of a DLT Platform



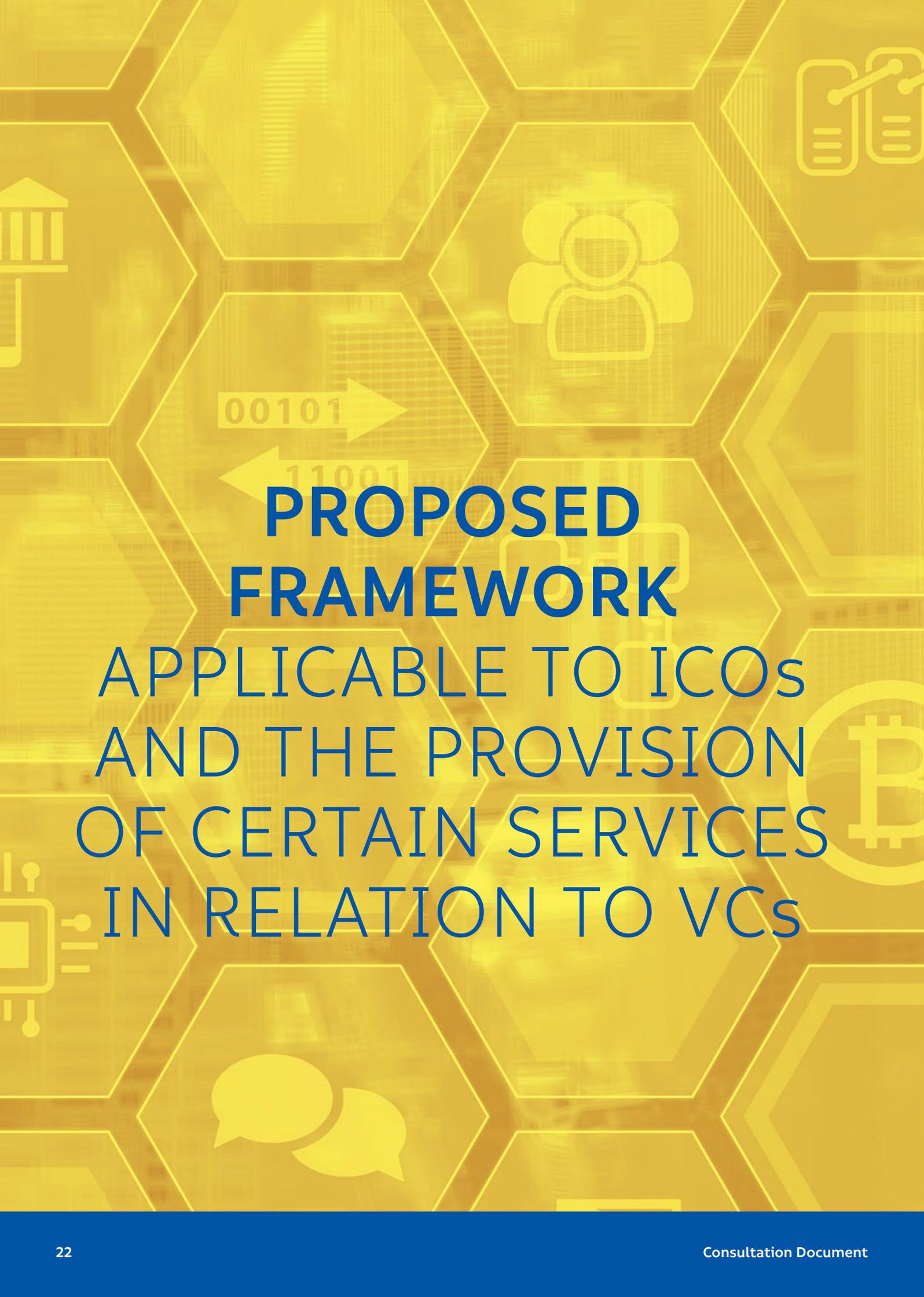
5.5 Practical Application 2: Approval of an ICO



YOUR FEEDBACK MATTERS

Do you agree with the approach outlined hereunder relating to the proposed framework for Technology Arrangements and Technology Service Providers?

- The definition of Technology Arrangement subject to certification by the MDIA in terms of the TAS Bill is restricted to DLT Platforms and related smart contracts.
- DLT Platforms and related smart contracts may, on a voluntary basis, seek certification by MDIA as a Technology Arrangement. The DLT Platform may or may not be constituted as a legal entity.
- A Technology Arrangement seeking certification by MDIA will be required to appoint an Administrator that is registered with the MDIA. An Administrator that is registered with MDIA and provides administration services to an MDIA certified Technology Arrangement will be required to ensure that the ongoing requirements relating to the certification of the Technology Arrangement are satisfied.
- When processing a request for the certification of a Technology Arrangement, the MDIA will undertake a principles based review of the characteristics of the proposed Technology Arrangement and may seek assurances from Auditors of Technology Arrangements (registered with the MDIA) engaged by the promoter of the proposed Technology Arrangement. These assurances will be taken into account by the MDIA for the purposes of the certification of the DLT Platform.
- The Administrator of a Technology Arrangement may be based in Malta or in another EEA State and may, on a voluntary basis, seek registration with the MDIA.
- The Auditor of a Technology Arrangement may be based in Malta or in another EEA State and may, on a voluntary basis, seek registration with the MDIA.
- The registration of an Administrator or Auditor of a Technology Arrangement will be subject to a fit and proper assessment by the MDIA which will take into account the competence and integrity of the proposed Administrator or Auditor.
- Any Technology Arrangements developed by entities subject to supervision by other NCAs may be subject to certification by MDIA if the respective NCA considers it desirable or necessary, taking into account the proposed use of the Technology Arrangement.



**PROPOSED
FRAMEWORK**
APPLICABLE TO ICOs
AND THE PROVISION
OF CERTAIN SERVICES
IN RELATION TO VCs



The Government is of the opinion that if properly regulated to achieve investor protection, market integrity and financial soundness, ICOs could become a suitable alternative means of finance for the industry. A framework covering ICOs needs to be accompanied with a regime that cover brokers, exchanges, wallet providers, advisors, wealth managers and market makers dealing in VCs.

In line with this policy, the MFSA has proposed a framework in the area of ICOs and the provision of certain services in relation to VCs with a view to ensure that investors dealing in VCs be it through participation in ICOs or the acquisition of VCs on exchanges or through brokers are afforded a high degree of investor protection and transparency.

The MFSA has been monitoring developments in the field of ICOs and the provision of services in relation to VCs, particularly the various policy documents and warnings issued by international standard setters, such as the Financial Action Task Force and the International Organization of Securities Commissions, and also the opinions issued by European Supervisory Authorities. Further to detailed and careful consideration of these international developments, the MFSA issued two consultation documents on the topics of collective investment schemes, VCs including ICOs and related service providers.

6.1 Feedback received by the MFSA from the Discussion Paper on Initial Coin Offerings, Virtual Currencies and related Service Providers

In general, the MFSA received positive feedback on its proposed framework for ICOs and the provision of certain services in relation to VCs. The proposed framework would regulate the carrying on of business associated with VCs falling outside the scope of the existing EU/National financial services legislation and make provision for matters ancillary thereto or connected therewith.

Respondents to the Discussion Paper expressed the concerns that the absence of specific regulation in this field makes ICOs and VCs a potential attractive route for illegal and fraudulent transactions to the detriment of bona fide investors. The feedback submitted supported the view that having a regulatory framework in place can serve as a filter against possible criminal infiltration and hence mitigating the risk of financial crime, including money laundering and funding of terrorism. There was general consensus that the introduction of a legislative framework would also ensure that investors get a fair deal in terms of transparency, the price formation process and the charging of fees, which would in turn not only improve investor protection and market integrity but also address the reputational concerns relating to this field of finance.

Additionally, the MFSA received overall support for the introduction of a 'Financial Instrument Test' proposed in the Discussion Paper that will provide the industry with regulatory certainty on whether, based on its specific features, an ICO or a VC falls within the scope of the existing legislative framework, reflecting EU law on the subject, or if not, whether this will be required to comply with the new regulatory framework being proposed by the MFSA.

The Government notes that the majority of respondents to the MFSA's Discussion Paper, recommend that the proposed framework should be pragmatic and not overly prescriptive to enable and not stifle technological innovation. This feedback supports the MFSA's proposal in the paper to introduce a legislative framework that will apply a principles-based approach to regulation supplemented by MFSA guidance, rather than detailed rules which would possibly restrict innovation.

A detailed statement summarising the feedback received by the MFSA on the Discussion Paper, setting out the MFSA's response and position thereto, is being prepared by the MFSA and will be issued in due course. The following sections provide an update on the development of the proposed 'Financial Instrument Test' and the new regulatory framework.

Financial Instrument Test

Further to the MFSA's Discussion Paper, and in line with ESMA's statement, certain ICOs and the provision of certain services in relation to VCs could fall within the scope of existing investment services legislation. It is within this context that the MFSA has proposed within the Discussion Paper, the introduction of a 'Financial Instruments Test', the purpose of which is to effectively determine whether a particular ICO or VC should classify as a financial instrument in terms of existing investment services legislation, or not, and if not, whether it will fall within the scope of the proposed VC Bill, or not.

The MFSA is proposing that the 'Financial Instruments Test' would be applicable to issuers and/or persons offering ICOs, conducted in or from Malta, to determine whether such activity is encompassed under the existing legislative and regulatory framework, which inter alia includes MiFID and the Prospectus Directive. The 'Financial Instruments Test' would also apply to persons providing services and/or performing activities in relation to non-classified VCs prior to the provision of any service so as to determine the applicable regime. Therefore, the purpose of the 'Financial Instruments Test' is to determine and establish the nature of a VC in terms of the law, which should give certainty regarding the regulatory treatment of this type of asset.

It is also being envisaged that the 'Financial Instruments Test' will consist of two stages. The first stage would effectively determine whether a particular VC qualifies as a financial instrument in terms of existing legislation, Maltese and EU. The second stage would determine whether the VC qualifies as an asset under the proposed VC Bill. It should be clarified that, in case of an affirmative determination during the first stage, the person undertaking the 'Financial Instruments Test' would not be required to proceed to the second stage. It is being proposed that the respective determination resulting from the 'Financial Instruments Test' will need to be verified by an external independent professional reviewer.

Proposed Legislative Framework on Initial Coin Offerings and the provision of certain services in relation to Virtual Currencies

Further to the MFSA's proposal included in the Discussion Paper for the introduction of a new legislative framework regulating ICOs and the provision of certain services in relation to VCs, and the industry's general consensus, evidenced by the ample positive feedback received by the MFSA in this regard, the Government endorses the development of such framework and more specifically the aim of ensuring investor protection, market integrity and financial soundness.



The aim of the proposed VC Bill shall be to create a framework in the field of ICOs as well as a regulatory framework application to service providers offering certain services in relation to VCs falling outside the scope of the current legislative and regulatory regime, when such activity is carried out in or from Malta. Further to discussions held with the MFSA on the feedback received from the industry, the Government agrees that the MFSA should pursue a primarily principles-oriented approach to regulation. Such an approach would prevent the provisions of the proposed VC Bill from both being rendered obsolete, considering the rapid technological advancements in this nascent industry, or as stifling innovation.

The proposed VC Bill shall encompass the following:

- i. ICOs which relate to those VCs not qualifying as financial instruments under the European and national investment services legislation. It shall set out the minimum transparency requirements applicable to such offerings as well as the obligations of the relevant parties involved. More specifically, the proposed VC Bill is set to integrate the high-level principles of the legislation applicable to initial public offerings, that must be adhered to by an issuer of VCs. In particular, it shall cover the information that needs to be communicated to the investors in the whitepaper and the additional transparency requirements applicable where the issuer intends to have a VC admitted to trading on an exchange;
- ii. Persons providing the services mentioned in the Discussion Paper in relation to the aforementioned ICOs and VCs. It shall set out inter alia the licensing requirements, procedure and ongoing obligations applicable to such persons, which shall reflect the high-level principles enshrined in the existing EU financial services legislation in relation to the provision of investment services, financial markets and market abuse;
- iii. The functions and powers of the MFSA as the regulator responsible for this field of financial services. More specifically, the proposed VC Bill will give MFSA the necessary regulatory and investigatory powers largely reflecting those under other national financial services laws, including the powers to issue directives, to adopt and publish rules, to require information, to introduce the 'Financial Instruments Test', to suspend either an ICO or the trading of a VC on an exchange, and to require the determination of a 'Financial Instruments Test' to be audited by an external independent professional reviewer. Furthermore, the proposed VC Bill sets the parameters for the European and international cooperation between the MFSA and other overseas regulatory authorities in line with Malta's European and International commitments.

With reference to points (i) and (ii) above, the exact categories of VCs and services falling within the proposed VC Bill, shall be determined further to the Authority's comprehensive review of the industry's respective feedback on the Discussion Paper. This notwithstanding, the MFSA is inclined towards excluding utility tokens, in their purest form, as well as certain services from the proposed framework's sphere. With regard to (iii) above, the Government is in consultation with the MFSA, to establish a decision-making mechanism within MFSA which will focus on Digital Financial Services, which mechanism will ensure full co-ordination with the newly established MDIA.

The Government further notes the definitions and classification of VCs proposed in the Discussion Paper, on the basis of which the scope of the proposed Bill shall be determined. In furtherance to consultations with the Authority, it has become evident from feedback received that the nomenclature should be revisited in view of the prevalent misconception that only Bitcoin and the other Altcoins comprise the spectrum of VCs, thereby disregarding a rather significant segment of the VC world. An amended classification is also required in view of the hybrid VCs, whose features may create issues vis-à-vis their classification. Therefore, the Government, further to discussions held with the Authority, welcomes the replacement of the current definitions and classification with alternative ones, more appropriate to achieve the aforementioned aim.

With regard to existing operators in this field falling under the proposed VC Bill, both the Government and the MFSA are in agreement that ensuring a seamless transition is of paramount importance in order to prevent any disruptions in the financial services cluster. The introduction of a transitory period of six months is proposed in this regard, in order to enable such persons to comply in full with the requirements emanating from the proposed VC Bill.



CONCLUDING REMARKS

The Parliamentary Secretary for Financial Services, Digital Economy and Innovation within the Office of the Prime Minister is seeking feedback from the general public and stakeholders before proceeding with the finalisation of the proposed framework and the preparation of the MDIA Bill and the TAS Bill.

The consultation is open from the 16th February, 2018 until the 9th March, 2018. Industry participants and interested parties are invited to send their responses to this Consultation Document on fsdei.opm@gov.mt.



PARLIAMENTARY SECRETARIAT FOR FINANCIAL SERVICES,
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OFFICE OF THE PRIME MINISTER