

A Regulatory Framework for Digital Transformation in Malta

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the 3 laws

the 3 laws...

1. **Malta Digital Innovation Authority Act**
 - Establishes the Malta Digital Innovation Authority
2. **Innovative Technology Arrangements and Services Act**
 - Sets out the regime for registration of Technology Service Providers and the certification of DLT Platforms – VOLUNTARY REGIME
3. **Virtual Financial Assets Act**
 - Sets out the regulatory regime governing ICOs and other intermediaries providing services to Virtual Currencies, such as brokers, exchanges and wallet providers – MANDATORY REGIME

GANADO
ADVOCATES

malta digital innovation authority

guiding principles of MDIA

- The **promotion and development** of the innovative technology sector through proper recognition and regulation:
 - **without hindering innovation**;
 - which will be **sensitive to change** in the sector;
 - **ensuring standards** (protection against abuse).
- The development of Malta as a **centre of excellence** for innovative technology.

governance of the MDIA

- MDIA is a body corporate having a distinct legal personality with legal and judicial representation of the MDIA shall vest in the Chairman
- Business of MDIA carried out by Board
- Board composed of Chairman and no less than 4 and no more than 8 members
- Members appointed by Minister responsible for Digital Economy for a minimum term of 1 year and a maximum of 3 years
- Members may be re-appointed

powers of the MDIA

- Power of MDIA to grant or refuse innovative technology authorisation
- Power to refuse to grant an innovative technology authorisation
- Power of MDIA to revoke, cancel or suspend Innovative technology arrangements authorisations and innovative technology services authorisations
- Power of Enforcement
- Power to exercise right of entry
- Power to request information
- Power to carry out inspections
- Power to impose Administrative Fines - max EUR350K for each infringement and EUR12K for each day of non compliance.

financing of MDIA

- Expenditure required for the proper performance of MDIA functions shall as far as practicable, be met out of its revenue
- The Authority shall be paid by Government out of the Consolidated Fund such sums as Parliament may from time to time authorise
- Government may make advances or lend money to MDIA
- MDIA to prepare estimates within 3 months from end of year

joint regulatory efficiency board

- There shall be a Joint Regulatory Efficiency Board to ensure effective cooperation between the MDIA and the other NCAs in the area of innovative technology uses. (Article 57(1))
- The Board shall have the function to facilitate cooperation between the relevant authorities in matters impacting on the use of technology, innovation and the development of Malta as an innovative technology uses.
- The Board shall have wide reaching powers and in particular shall **act as the medium to establish national standards** when as to do so by any NCA with reference to innovative technology arrangements and their uses.
- The Board shall meet not less frequently than once every month.



innovative technology arrangements and services framework

ITAS framework

- Innovative Technology Arrangements and Services Act
- Innovative Technology Arrangements and Services (Fees) Regulations, 2018
- Chapter 1: Part A - Systems Auditor Guidelines
- Chapter 1: Part B - Systems Auditor Report Guidelines
- Chapter 1: Part C - Systems Auditor Control Objectives
- Chapter 2: Innovative Technology Arrangements Guidelines
- Chapter 3: Technical Administrator Guidelines
- Chapter 4: Resident Agent Guidelines

ITAS framework

- Enhanced Systems Audit/ or Guidelines
- Guidelines on the definition of “In or From Malta”
- ITA Blueprint Guidelines
- Technology Stack Nomenclature
- Forensic Noted Guidelines

a certification regime

- Voluntary regime
- Certification of 'innovative technology arrangements and services'
- The 'ISO standard' for this industry
- What are 'innovative technology arrangements'?
- What are 'innovative technology services'?

first schedule

The following shall be considered to be innovative technology arrangements for the purposes of this Act:

1. **software and architectures which are used in designing and delivering DLT which ordinarily, but not necessarily:**
 - (a) uses a distributed, decentralized, shared and, or replicated ledger;
 - (b) may be public or private or hybrids thereof;
 - (c) is permissioned or permissionless or hybrids thereof;
 - (d) is secure to a high level against retrospective tampering, such that the history of transactions cannot be replaced;
 - (e) is protected with cryptography; and
 - (f) is auditable.

first schedule

The following shall be considered to be innovative technology arrangements for the purposes of this Act:

2. **Smart contracts** and related applications, including decentralised autonomous organisations, as well as other similar arrangements;
3. **Any other innovative technology arrangement which may be designated by the Minister**, on the recommendation of the Authority, by notice from time to time.

second schedule

'**innovative technology services**' are those services in relation to innovative technology arrangements as are designated in the Innovative Technology Arrangements and Services Act, 2018.

The following shall be considered to be innovative technology services for the purposes of this Act:

1. the review services referred to in this Act with reference to innovative technology arrangements provided by **system auditors**;
2. the technical administration services referred to in this Act with reference to innovative technology arrangements provided by **technical administrators**.

registration of service providers

- Registration Requirement for providers of Innovative Technology Services (ITSPs)
- The registration for the provision of one type of service shall not bar the registration of the same person to provide other types of services.
- MDIA may designate and make public any international or other standards of service it may rely on when considering a registration of ITSP.

registration of service providers

Registration process focuses on:

- The fit and proper of service provider, its qualifying shareholder (25%), administrators/ directors
- The qualifications and experience of service provider
- The technical resources or third party support, personally, through delegates or through automated systems of service provider
- The ability of the service provider to comply with and observe any innovative technology authorisation rules and regulations applicable to him

registration of service providers

An innovative technology service provider shall:

- conduct its business with honesty and integrity;
- pay due regard to the rights, interests and needs of each and all its customers
- communicate its clients in a way that is fair, clear and not misleading
- manage and control its business effectively
- conduct its business with due skill, care and diligence; and
- have effective arrangements in place, through human resources, including third party delegates or contractors, financial resources as well as technology facilities to be able to meet its operational and compliance obligations.



virtual financial assets framework

virtual financial assets

regulatory framework

- Virtual Financial Assets Act
- Virtual Financial Assets Regulations
- Chapter 1: VFA Rules applicable to VFA Agents
- Chapter 2: VFA Rules applicable to Issuers of Virtual Financial Assets
- Chapter 3: VFA Rules applicable to VFA Service Providers
- Guidance Note: Financial Instrument Test
- Guidance Note: Cybersecurity
- FAQ: VFA framework

virtual financial assets

regulatory framework

- Sets out the regulatory regime for VFA Agents
- Sets out the regulatory regime governing offer of Virtual Financial Assets to the public and the listing of Virtual Financial Assets
- Creates mandatory authorisation requirements for providers of the following VFA Services:
 - i. VFA Exchanges
 - ii. Wallet Providers (safekeeping)
 - iii. Dealing on Own Account
 - iv. Execution of Orders

virtual financial assets

regulatory framework

- Creates an authorisation requirements for providers of the following VFA Services:
 - v. Reception and Transmission of Orders
 - vi. Placement
 - vii. Portfolio Management
 - viii. Investment Advice

virtual financial assets

regulations

- Exemptions
- Fees
- Classes of Licences - 4 Classes of Licences
- Control of Assets

virtual financial assets rulebook

Chapter 1: Rules applicable to VFA Agents

- Only the following persons can act as VFA Agents:
 - a. advocates, accountants, or auditors; or
 - b. a firm of advocates, accountants, or auditors, or corporate service providers; or
 - c. a legal organisation wholly owned or controlled by persons in (a) or (b); or
 - d. any other class of persons holding authorisations, qualifications and experience deemed by the MFSA as possessing suitable expertise to exercise the functions listed under Articles 7 and, or 14 of the Virtual Financial Assets Act.

virtual financial assets rulebook

Chapter 1: Rules applicable to VFA Agents

- Sets out detailed requirements for VFA Agents
- Introduced concept of Designated Persons
- Minimum Regulatory Capital (EUR75K+PII/ EUR150K)
- Requirements on (i) Client-On Boarding Process, (ii) need to have several policies dealing with Remuneration, Conflicts etc., (iii) Record Keeping Requirements (iv) PII requirements

virtual financial assets rulebook

Chapter 2: Rules applicable to Issuers of VFAs

- Issuer defined as *“a legal person duly formed under any law for the time being in force in Malta which issues or proposes to issue virtual financial assets in or from within Malta”*.
- Art 3(1) of the VFA Act provides that no Issuer shall offer a VFA to the public in or from within Malta or apply for their admission to trading on a DLT exchange unless such Issuer draws up a whitepaper that includes the disclosure requirements set out in the 1st Schedule to the VFA Act and registers same with MFSA.
- Issuer to undertake Financial Instrument Test prior to the

virtual financial assets rulebook

Chapter 2: Rules applicable to Issuers of VFAs

- The Issuer's business shall be effectively directed or managed by at least two individuals in satisfaction of the 'dual control' principle.
- The Issuer shall commence the offering of its Virtual Financial Assets to the public or shall proceed with the admission of its Virtual Financial Assets to trading within six months from the registration of the whitepaper with MFSA.
- The Issuer shall ensure that an investor does not invest more than EUR 5,000 in its Initial VFA Offerings over a 12-month period. Provided that this Rule shall not apply to Experienced

virtual financial assets rulebook

Chapter 2: Rules applicable to Issuers of VFAs

- Issuer to draw up an Annual Compliance Certificate to be reviewed by the Issuer's VFA Agent covering AML/ CFT Requirements, Compliance with Rules etc.
- Independent audit report on Issuer's AML/CFT processes.
- Issuer must appoint and have in place at all times: (i) a Systems Auditor, (ii) a VFA Agent, (iii) a Custodian, (iv) an Auditor, and (v) a Money Laundering Reporting Officer ('MLRO').

virtual financial assets rulebook

Chapter 3: Rules applicable to VFA Service Providers

- Governance - Business to be directed by at least 2 individuals
- Establishment of various policies and procedures (decision making, internal controls, internal reporting, communication of information, record keeping, security measures, remuneration policy, conflicts policy, risk management framework, business continuity plan, disaster recovery plan, inducements, personal transactions, order execution policy)
- Establishment of Cyber Security Framework

virtual financial assets rulebook

Chapter 3: Rules applicable to VFA Service Providers

- Establishment of a Compliance and AML functions
- Submission of Annual Compliance Certificate to MFSA
- Rules for Segregation of Clients Assets
- Monthly reconciliations of VFAs held under custody & Clients' Money (FIAT)
- Establishment of Internal Audit Function (not mandatory)

virtual financial assets rulebook

Chapter 3: Rules applicable to VFA Service Providers

- Need for PII Cover
- Framework for outsourcing and related oversight
- Additional Rules for VFA Exchanges in particular on the listing criteria
- Capital requirements and own funds including fixed overhead requirements and RMICAAP
- Distinction between Retail and Professional Clients

virtual financial assets rulebook

Chapter 3: Rules applicable to VFA Service Providers

- Independent vs Non Independent Advice
- Appropriateness and Suitability Assessment
- Issue of Suitability Statement
- Complaints Handling Process
- Record Keeping 5 years, possibly 7
- Audited Accounts within 4 months from Y/E.

virtual financial assets rulebook

Chapter 3: Rules applicable to VFA Service Providers

- Quarterly Interim and Annual Financial Return within 1 month
- Disclosure of (a) risk management framework, (b) governance, (c) own funds and (d) capital requirements

the financial instrument test

The VFA Act provides that a “DLT asset” is:

- i. a virtual token;
- ii. a virtual financial asset;
- iii. electronic money; or
- iv. a financial instrument,

that is intrinsically dependent on, or utilises DLT.

the financial instrument test

- Unlike what the name implies the Financial Instrument Test is used for the purposes of the classification a DLT Asset as a: (A) a virtual token; (B) virtual financial asset; (C) electronic money; or (D) a financial instrument.
- Guidance note gives direction and if correctly applied certainty
- Assessment can be rather complicated

the financial instrument test

virtual financial asset

"virtual financial asset" or "VFA" means any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value and that is not -

(a) electronic money;

(b) a financial instrument; or

(c) a virtual token;

the financial instrument test

e-money

- The VFA Act, refers to the Financial Institutions Act for the definition of electronic money
- We need to determine whether the DLT Asset qualifies as electronic money

the financial instrument test

e-money

- "electronic money" means electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions and which is accepted by a natural or legal person other than the financial institutions that issued the electronic money

the financial instrument test

e-money

- EBA Report of January, 2019 on crypto assets lists the following six characteristics for E-Money:
 - i. is electronically stored;
 - ii. has monetary value;
 - iii. represents a claim on the issuer;
 - iv. is issued on receipt of funds;
 - v. is issued for the purpose of making payment transactions;
 - vi. is accepted by persons other than the issuer.

the financial instrument test

virtual token

- “virtual token” means a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform on or in relation to which it was issued or within a limited network of DLT platforms:

the financial instrument test

virtual token

Provided that the term 'DLT platform' referred to in this definition shall exclude DLT exchanges.

Provided further that a virtual token which is or may be converted into another DLT asset type shall be treated as the DLT asset type into which it is or may be converted.

the financial instrument test

financial instrument test

Based on the list of Financial Instruments under MIFID:

- A. Transferable Securities
- B. Money Market Instrument
- C. Collective Investment Schemes
- D. Financial Derivative Instruments
- E. Emissions Allowances

**the future:
security tokens and security token
exchanges**

security tokens

- Framework based on EU Directives, principally the Prospectus Directive
- Prospectus Directive covers the offer of securities to the public and the admission of a security to listing
- Disclosure based regime
- MFSA is the Listing Authority
- Different issuing models available
- Private Law issues eg Companies Act (being addressed)

security token exchanges

- Framework based on EU Directives, principally the MIFID II and MIFIR
- CSD Regulations and Market Abuse Directive also relevant
- Can be set up as a Regulated Market or a Multilateral Trading Facility.
- MFSA is the Competent Authority
- Business Model still not clear: Intermediated vs Disintermediated
- Operational issues including the interplay of the Blockchain

MFSA initiatives

- MFSA's Fintech Strategy based on 6 pillars:
 1. Regulations
 2. Ecosystem
 3. Architecture
 4. International Links
 5. Knowledge
 6. Security
- Consultation Document: Pillar 1
- Consultation Document: Security Token Offerings



concluding remarks

concluding remarks

- Framework very comprehensive.
- Covers the technology and the main service providers as well as intermediaries and issuers of virtual financial assets
- Regulatory framework for VFA Service Providers and Issuers of VFA is based on EU regulatory principles
- Sector still in its infancy but with a huge potential for growth

thank you.

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