



## BERMUDA'S DIGITAL ASSET BUSINESS REGULATORY REGIME

Having successfully launched the world's most progressive ICO legislation, the Digital Asset Business Act 2018 (**DABA**) is Bermuda's latest development in establishing a comprehensive legislative and regulatory framework designed to support and facilitate growth in the financial technology (**Fintech**) sector.

Bermuda introduced the digital asset business legislation in the form of the Digital Asset Business Act 2018 which became operative on 10 September 2018, as well as prudential rules including the Digital Asset Business (Client Disclosure) Rules 2018, the Digital Asset Business (Cybersecurity) Rules 2018, and the Digital Asset Business (Prudential Standards) (Annual Return) Rules 2018 each of which became operative on 11 September 2018 (together the "**DABA Legislation**").

The DABA Legislation regulates digital asset business carried on in or from within Bermuda and protects the interests of clients or potential clients of persons carrying on the business of digital asset business.

There are substantial penalties under the DABA Legislation for anyone who fails to comply with any requirement or contravenes any prohibition imposed by or under DABA, including potential fines of up to \$10,000,000.

### **Digital Asset Business**

DABA defines 'digital asset business' as 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 utilising digital assets which includes the provision of services for the transfer of funds;
- c) operating as an electronic exchange;
- d) providing custodial wallet services; or
- e) operating as a digital asset services vendor.

## Application and Effect

The DABA Legislation makes digital asset business a regulated industry, and provides that a person cannot carry on digital asset business in or from within Bermuda unless the person is a licensed undertaking in one of the classes specified in DABA or falls within an exempt category as provided in an exemption order issued pursuant to DABA.

This means that any company wishing to carry out digital asset business will require the consent of the Bermuda Monetary Authority (**Authority**) and the grant of a licence under the DABA Legislation.

A detailed, comprehensive digital asset business application must be submitted to the Authority for the licensure of an entity under DABA in the appropriate form and must state the class of digital asset business licence required. There are two classes of digital asset business licences which may be applied for as follows:

- (a) class F licence under which a person shall be licensed to provide any or all of the digital asset business activities under the definition of digital asset business; or
- (b) class M licence, under which a person shall be licensed to provide any or all of the digital asset business activities under the definition of digital asset business for a defined period determined by the Authority.

Any company submitting a digital asset business application must include the following documentation which must be provided to the Authority in English:

- a cover letter providing an executive summary of the application, and highlighting how the minimum licensing criteria for the relevant class or category of Digital Asset Business being applied for is satisfied; and in cases where required documentation has not been provided by the applicant within its application, a written explanation for the said omission(s) is required;
- copies of the Memorandum of Association, Certificate of Incorporation or Registration Permit (if available);
- a business plan dealing with key items, such as:
  - (i) ownership of the applicant, including identification of its ultimate parent and other relevant details of its group organisational structure;
  - (ii) Information, including curriculum vitae, on the applicant's board of directors, and senior management;
  - (iii) description of the applicant's business purpose for licensing in Bermuda, outlining the rationale for Bermuda as the chosen jurisdiction;
  - (iv) Business strategy and risk appetites;
  - (v) insurance details and description of mitigation;

- (vi) financial assessment;
- (vii) explanation of how the applicant plans to meet head office requirements;
- (viii) projections of staffing requirements; and
- (ix) description of risk management, internal audit and compliance functions;
- a copy of its Anti-Money Laundering and Anti-Terrorism Financing policies and procedures;
- information in respect of the applicant's corporate shareholders and ultimate beneficial owners;
- information in respect of individual shareholders and ultimate beneficial owners;
- a copy of the applicant's proposed cybersecurity programme, including policies and procedures related to hot and cold customer private key storage;
- description of the steps that either have been taken (or will be and associated timing) to ensure that the Authority has access to a node or other arrangement to allow the Authority to monitor both the client and the applicant's own digital asset transaction records with online or automated real-time read-only access, and provision of wallet public addresses (hot wallet addresses (if used) and customer deposit addresses);
- acceptance letters indicating unconditional acceptance from the applicant's approved auditor and senior representative(s);
- curriculum vitae of applicant's senior representative(s);
- address of the applicant's head office; and
- a declaration from an officer of the applicant that the applicant is aware of and will abide by the Code of Practice as required pursuant to the Digital Business Act 2018.

Applicants for a continuation of an overseas operation from a foreign jurisdiction into Bermuda must additionally provide:

- a certificate of Good Standing from the relevant regulatory authority in the foreign jurisdiction;
- contact information for the regulatory authority in the relevant foreign jurisdiction, including contact person name/title, organisation name/address, e-mail address and telephone contact details; and
- copies of the most recent statutory financial statements and/or any other relevant financial information evidencing compliance of the applicant with the capital, solvency and liquidity requirements of the foreign jurisdiction.

There are additional requirements for Class M applications which include the provision of details of the entity's roadmap to deploy services and delivery mechanisms on a broader scale once the modified class licence has expired.

The Authority's Assessment and Licensing Committee (**ALC**) consists of senior management from the supervisory, policy and information technology departments within the Authority. The ALC generally convenes once a week to

review the applications presented for consideration in order to reach consensus on whether to approve, defer or decline the applications for licensing. Applicants will be informed of the ALC decision as soon as possible subsequent to the meeting, followed by a formal letter from the Authority confirming the same.

### **Minimum Criteria**

The Authority will not grant a digital asset business licence unless it is satisfied that the minimum criteria set out in DABA are fulfilled with respect to the applicant. The minimum criteria for licensing include:

- controllers and officers to be fit and proper persons;
- business to be conducted in a prudent manner;
- integrity and skill;
- corporate governance; and
- consolidated supervision.

Any licence issued by the Authority may be subject to such limitations on the scope of the digital asset business activity or the manner of operating the digital asset business as the Authority may determine to be appropriate having regard to the nature and scale of the proposed business. Further, a licence may be revoked by the Authority if any of the minimum criteria is not (or has not been) fulfilled in respect of a licensed undertaking.

### **Compliance**

Companies conducting digital asset business must employ a risk-based approach to determine the appropriate levels of customer due diligence (**CDD**) measures for different customer types, proportionate risk-mitigation measures and measures for monitoring, detecting and reporting suspicious activity to the appropriate authorities, as well as monitoring for activity that may increase a customer's risk profile.

Using the risk-based approach, each company conducting digital asset business should determine the amount of money laundering (**ML**)/terrorist financing (**TF**) risk it will accept in pursuit of its business goals. The digital asset business sector is often considered as posing a high risk of ML/TF, but not all digital asset businesses are inherently high-risk for ML/TF. Therefore, the business's risk assessment should identify categories of customers and transactions that are higher or lower risk within a particular product or service.

Digital asset businesses must carry out CDD on their customers as well as on the customers' beneficial owners. Companies must be vigilant and ensure they obtain sufficient information on each customer at account opening, as well as establish appropriate transaction monitoring rules in their systems to flag unexpected activity or activity that does not appear commensurate with a customer entity type or a customer's nature of business or occupation.

The DABA Legislation also requires every licenced undertaking to file an annual cyber security report prepared by its chief information security officer on an annual basis setting out the availability, functionality and integrity of its electronic systems, and identifying cyber risk arising from any of its digital asset business as well as the cyber security program implemented and proposals for steps for the redress of any inadequacies identified.

The cyber security program of a licensed undertaking shall include, but is not limited to, the audit functions set forth below:

- (a) penetration testing of its electronic systems and vulnerability assessment of those systems conducted at least on a quarterly basis; and
- (b) audit trail systems that—
  - (i) track and maintain data that allows for the complete and accurate reconstruction of all financial transactions and accounting;
  - (ii) protect the integrity of data stored and maintained as a part of the audit trail from alteration or tampering;
  - (iii) protect the integrity of hardware from alteration or tampering, including by limiting electronic and physical access permissions to hardware and maintaining logs of physical access to hardware that allows for event reconstruction;
  - (iv) log system events including but not limited to access and alterations made to the audit trail systems, and Cyber Security Events; and
  - (v) maintain records produced as part of the audit trail.

In addition to these compliance measures, every licenced entity must prepare and deliver to the Authority a certificate of compliance within four months from the end of its financial year which must be signed by two directors, or one director and an officer of the undertaking, certifying that to the best of their knowledge the entity has complied with the minimum criteria as set out in DABA and codes of practice.

## **Summary**

The DABA Legislation represents another significant and substantial step forward in the Fintech sector, indicating that Bermuda is indeed executing its plan to become a global leader in the Fintech industry.

As the Fintech space continues to evolve, BeesMont's dedicated Technology & Innovation Team remains actively engaged with relevant Government parties and the Bermuda Monetary Authority and is advising clients who operate or intend to operate in Bermuda's Fintech environment.

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Please do not hesitate to contact Stephanie Paiva Sanderson, Head of Technology & Innovation, [spsanderson@beesmont.bm](mailto:spsanderson@beesmont.bm), or your usual contact at BeesMont Law Limited to discuss your Fintech needs.

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