

CONSULTATION PAPER ON ACHIEVING A
HIGHER DEGREE OF INVESTOR PROTECTION
UNDER THE VIRTUAL FINANCIAL ASSETS ACT

MFSA REF: 10-2018

ISSUED: 21 AUGUST 2018

CLOSING DATE: 31 AUGUST 2018

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

THESE PROPOSALS ARE NOT BINDING AND ARE SUBJECT TO CHANGES AND REVISIONS FOLLOWING REPRESENTATIONS RECEIVED FROM LICENCE HOLDERS AND OTHER INVOLVED PARTIES. IT IS IMPORTANT THAT PERSONS INVOLVED IN THE CONSULTATION BEAR THESE CONSIDERATIONS IN MIND.

1 INTRODUCTION

Regulation safeguarding market integrity and protecting consumers of financial services is crucial for market confidence. The Malta Financial Services Authority ('MFSA' or 'the Authority') has taken note of a number of articles in international media which cite an increase in fraudulent activity and scams in relation to the cryptocurrency field.¹ As a result, and in line with the functions of the Authority as set out in the Malta Financial Services Authority Act (Chapter 330 of the Laws of Malta), the MFSA is proposing additional regulation in relation to Initial VFA Offerings to complement the rules proposed in the [Consultation Paper on the Virtual Financial Assets Rules for Issuers of Virtual Financial Assets](#), Chapter 2 of the proposed Virtual Financial Assets Rulebook ('Chapter 2 of the Rulebook').

Chapter 2 of the Rulebook which was issued for consultation on the 30 July 2018, already sets out a number of measures which are aimed at safeguarding investors and ensuring market integrity. These *inter alia* include the appointment of a number of functionaries, such as the Money Laundering Reporting Officer, requirements relating to cyber-security and record keeping, transparency and admission to trading on a DLT exchange. The consultation period for Chapter 2 of the Rulebook closed on the 13 August 2018 and the Authority is pleased to note that numerous feedback has been submitted by various stakeholders. The MFSA is currently analysing, evaluating and considering all feedback received and shall be making amendments to the proposed regulations and rules, as may be necessary.

In order to further mitigate risks and enhance investor protection, the Authority is proposing a number of changes set out in subsequent sections of this consultation document.

The scope of this Consultation is to obtain industry feedback in relation to the Authority's proposals.

2 THE APPOINTMENT OF A CUSTODIAN

Currently, R2-2.4.1.2 of the proposed Chapter 2 of the Rulebook, states that "*an Issuer may appoint a Custodian for the safekeeping of its assets and investors' funds.*" The proviso to the rule, then states that "*in the absence of an appointed Custodian, all references to a 'Custodian' in this Chapter shall, unless otherwise indicated, be read and construed as a reference to the Issuer and the respective rules shall apply to the Issuer mutatis mutandis.*" R2-2.4.4.3 follows to state that where an Issuer appoints a Custodian, such custodian shall be a legal person in possession of a licence to provide the services of a Custodian in terms of the Act; and has appropriate systems and controls to ensure that investors' funds are reimbursed if the Initial VFA Offering is cancelled for any reason whatsoever, including *inter alia* where the set soft cap, as stated in the Issuer's whitepaper, is not reached.

¹ See for example, <https://uk.reuters.com/article/uk-britain-markets-cryptocurrencies/british-watchdog-says-cryptocurrency-scams-on-the-rise-idUKKBN1L216A>

The MFSA is now proposing that the safekeeping of an Issuer's assets and investors' funds ('custody') is performed as follows:

- (1) For virtual financial assets, with an independent third party with whom the Issuer has made the necessary arrangements for custody. An Issuer may appoint a Custodian constituted either in:
 - a. Malta, provided that such person is appropriately licenced in accordance with the Virtual Financial Assets Act ('the Act'); or
 - b. a recognised jurisdiction, provided that the Issuer shall outline within its whitepaper the arrangements that will be put in place to ensure adequate safekeeping of its assets and investors' funds.

- (2) For fiat currencies, with a
 - a. central bank;
 - b. credit institution authorised in accordance with the provisions of Directive 2013/36/EU;
 - c. bank authorised in a third country; or
 - d. qualifying money market fund.

- (3) The MFSA is also considering custody to be performed through the use of a technology arrangement, which is duly certified by a systems auditor.

3 MONITORING OF MILESTONES

Point 7 (j) of the First Schedule to the Act requires the Issuer to provide a detailed description of the past and future milestones and project financing within the whitepaper. Currently, the rules proposed in the [Consultation Paper on the Virtual Financial Assets Rules for VFA Agents](#), Chapter 1 of the proposed Virtual Financial Assets Rulebook ('Chapter 1 of the Rulebook'), particularly R1-3.3.4 and R1-3.3.5, require the VFA Agent to ensure that the Issuer has provided investors with a roadmap setting out the milestones for the Initial VFA Offering and to check whether the Issuer is meeting the said milestones. In the event that these milestones are not being met, the VFA Agent would be required to inform the MFSA accordingly.

The MFSA is now proposing that R1-3.3.4² of Chapter 1 of the Rulebook and R2-2.4.3.8 (ii)³ of Chapter 2 of the Rulebook are reworded in order to better reflect point 7 of the First Schedule to the Act by inserting the words 'to the extent it is applicable'.

² The requirement for a VFA Agent to ensure that the Issuer has provided investors with a roadmap setting out the milestones for the Initial VFA Offering.

³ The requirement for an Issuer to provide its VFA Agent with a confirmation that it has provided investors with a roadmap which clearly establishes and sets out milestones for the Initial VFA Offering.

In addition to the above, a disclosure regime is being proposed for Issuers whose business model necessitates the setting out of milestones within the whitepaper. The Authority is proposing requiring such Issuers to disclose progress, by means of public announcements, on the date set out for each milestone within the roadmap provided to investors, and in case of deviations therefrom, to highlight such deviations in the said public announcement.

4 A MAXIMUM INVESTMENT LIMIT FOR RETAIL CUSTOMERS

In order to limit exposures in case of failure, the MFSA is also considering an approach similar to that taken with respect to Investment-Based Crowdfunding⁴ by imposing a cap on the investible amount. In this respect, the MFSA is considering the possible introduction of a maximum investment amount for an Initial VFA Offering of Euro 5,000 per issuer over a period of 12 months, applicable to retail investors as defined by MiFID.

5 CONCLUDING REMARKS

The consultation is open to the public from 21 August 2018 until the 31 August 2018. Interested parties are requested to submit their comments and feedback by email on fintech@mfsa.com.mt by not later than **31 August 2018**.

Communications Unit
Malta Financial Services Authority
MFSA Ref: 10-2018
21 August 2018

⁴ *Requirements Regarding Applications For A Licence To Carry Out Investment-Based Crowdfunding Under The Investment Services Act* ([link](#)).

MFSA

MALTA FINANCIAL SERVICES AUTHORITY