



GIBRALTAR FINANCE

HM Government of Gibraltar

Proposals for a DLT Regulatory Framework

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Foreword

The Hon Albert Isola - Minister for Commerce

In my budget address in 2016, I referred to the continued work undertaken by the Cryptocurrency Working Group. This team, set up as a private sector initiative under my direction, provided in depth research and information on whether Gibraltar should look to develop its presence in this exciting area. Their report of 2016 was the second phase of a public consultation and provided us with a strong indication that we should continue this work stream. A strongly expressed preference in the initial consultation process was that supervision would be best placed in the hands of the Gibraltar Financial Services Commission (**GFSC**). We considered very closely the valuable feedback provided to us by many interested parties representing both the Gibraltar private sector and externally. As a result, I instructed the GFSC to create proposals for a regulatory framework for Government's consideration. I am therefore delighted to publish these proposals today for widespread public consultation and I look forward to receiving detailed views from as wide an audience as possible. May I take this opportunity of extending my thanks to all those people that have assisted in providing us with their views to date. What is clear to Government is that Gibraltar is very well placed to harness the benefits that come with supporting new technology sector firms as a catalyst to the continued economic development of Gibraltar.

Samantha Barrass – CEO Gibraltar Financial Services Commission

One of the GFSC's priorities for the year ahead is to continue to actively support the development of new markets and activities in Gibraltar, promoting innovation that is well considered and safe for consumers and the jurisdiction.

Over the past 12 months we have been working closely with HM Government of Gibraltar in developing proposals for a new regulatory framework for firms engaging in activities that use Distributed Ledger Technology (**DLT**) for the transmission or storage of value belonging to others. The proposed framework will facilitate a progressive, well-regulated and safe environment for firms using DLT to grow, whilst also ensuring that this new regulatory environment protects both consumers and the good reputation of the jurisdiction. We look forward to engaging with the public and receiving feedback on this exciting project.



Executive summary

The earlier discussion paper, *Virtual Currency: Outline Regulatory Framework*, issued by HM Government of Gibraltar (HMGGoG) Cryptocurrency Working Group (CWG) in January 2016, had as its main focus the regulation of Virtual Currencies and its intermediaries. We now want to take the same philosophy and expand this to distributed ledger technology (DLT), the technology underpinning decentralised virtual currencies. There are many other financial and non-financial use cases for DLT, including in government and the wider public sector.

HMGGoG is now considering the introduction of appropriate legislation to provide an efficient, safe and innovative regulatory framework and have worked with the Gibraltar Financial Services Commission (GFSC) and the CWG to deliver this proposed regulatory framework for firms engaging in activities not otherwise subject to regulation and that use DLT for the transmission or storage of value belonging to others (DLT framework).

The primary driver for the DLT framework is to encourage Gibraltar's economic development while providing safeguards for consumers and protecting the jurisdiction's reputation and integrity. The DLT framework is designed to be both good for Gibraltar and safely so. It recognises Gibraltar's status within the EU while considering the likely impact of Brexit and related outcome scenarios.

The DLT framework positions Gibraltar as a jurisdiction, which facilitates innovation whilst ensuring it continues to meet its regulatory and strategic objectives, and understands the modern need for a robust and speedy interaction with regulators in this fast moving area of business. The DLT framework will apply to activities not subject to regulation under another framework and that use DLT for the transmission or storage of value belonging to others (DLT firms). Firms and activities that are subject to another regulatory framework will continue to be regulated under that framework.

The proposed role of the GFSC will be to authorise and supervise DLT firms. Consideration will be given to granting discretionary powers to the Chief Executive to impose appropriate conditions and restrictions, from time to time, to ensure the DLT framework principles are properly applied to firms operating with an evolving nascent technology.

It is proposed that the Chief Executive and Board are assisted by a specialist advisory panel appointed by the Minister, comprising technology and regulation experts in the field of DLT and virtual currencies.

The proposals include for amendments to be made to regulations under the Financial Services (Investment and Fiduciary Services) Act 1989, with a proposed operative date no later than 1st January 2018. Proposed transitional arrangements will permit firms that apply in the first 3 months from the operative date to continue providing DLT activities until their application is determined.

Although initial costs will be funded from existing GFSC resources, the proposed DLT licensing regime is intended to be sustained by annual licence fee income. Initial application fees will be kept modest to attract new entrants and encourage start-ups to apply.



Introduction

Background

This consultation paper builds on an earlier discussion paper, *Virtual Currency: Outline Regulatory Framework*¹, published in January 2016 by HMGoG CWG. It has been created in partnership with the GFSC and in consultation, as required, with leading industry experts.

Decentralised virtual currencies (**VC**), such as Bitcoin, allow two people to exchange value directly with one another, without the need for an intermediary, and to do it wholly digitally. They are both a currency and a payment system, rolled into one.

The Financial Action Task Force defines VC as '*a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency," "real money," or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency - i.e., it electronically transfers value that has legal tender status.*'²

Bitcoin was the first modern peer-to-peer VC, described in a 2008 white paper³ and with its first transaction undertaken in 2009. DLT⁴, also commonly known as **blockchain** (although there are nuanced differences between the two), is the technology underpinning Bitcoin and most other decentralised virtual currencies.

Since the work undertaken by the CWG, several reports have been published by national bodies and multi-national institutions highlighting the innovative potential of DLT that is expected to drive transformational change in the way the world both conducts business and delivers public services.

Most notable among the reports were those published by:

- UK Government Chief Scientific Adviser, Sir Mark Walport
- International Monetary Fund

¹ *Virtual Currency: Outline Regulatory Framework* published by the Working Group on Virtual Currency, v1.05, 29 January 2016

² *Virtual Currencies: Key Definitions and Potential AML/CFT Risks*, FATF, June 2014, <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>

³ *Bitcoin: A Peer-to-Peer Electronic Cash System*, Satoshi Nakamoto, October 2008, <https://bitcoin.org/bitcoin.pdf>

⁴ For a detailed and in-depth examination of distributed ledger technology, see the *Whitepaper on Distributed Ledger Technology* commissioned by the Hong Kong Monetary Authority, ASTRI, 11 November 2016, http://www.hkma.gov.hk/media/eng/doc/key-functions/financial-infrastructure/Whitepaper_On_Distributed_Ledger_Technology.pdf



- European Parliament
- World Economic Forum.

These reports, and many others published by the private sector including leading advisory firms, focus heavily on what lies beyond virtual currencies, namely, DLT and its use cases. PWC, for example, titled a recent report⁵ *Blockchain: The \$5 billion opportunity for reinsurers*, referring to DLT as being '*...made for reinsurance*' and '*...a straightforward opportunity to cut costs and improve client satisfaction within reinsurance*'.

The European Parliament's report, *Virtual currencies*⁶, gave equal consideration to DLT, referring to 'DLT' in the title of two of its three sections and noting:

- "that DLT's potential to accelerate, decentralise, automate and standardise data-driven processes at lower cost has the potential to alter fundamentally the way in which assets are transferred and records are kept, with implications for both the private and the public sector"
- "that clearing, settlement and other post-trade management processes [...] and bank reconciliation processes are areas where the use of DLT might turn out to be transformational in terms of efficiency, speed, and resilience"
- "that DLT could be used to increase data sharing, transparency and trust not only between government and citizens, but also between private sector actors and clients"
- "the still unfolding potential of DLT [*going*] well beyond the financial sector"
- "the potential of DLT in assisting governments to reduce money laundering, fraud and corruption".

At the time of writing, over 80 of the world's leading financial institutions are members of the R3 DLT consortium, including Bank of America, Barclays, BBVA, BNP Paribas, Citi, Deutsche Bank, HSBC and Mizuho.

In his 2016 Mansion House speech⁷, Sir Mark Carney, Governor of the Bank of England, talked of "*...the potential of distributed ledger technology to simplify the settlement chain, reduce its cost, and raise its speed while increasing resilience. The instruments involved range from equities to bank loans*" and went on to discuss "*... exploring the use of Distributed Ledger [...] technology in our core activities, including the operation of RTGSs*"⁸ and declaring "*The great promise of distributed ledgers for central banks is their potential to enhance resilience.*" Subsequently, the Bank of England published a working paper positing central bank issued digital currencies which it suggests would, for practical purposes, be based on DLT.

⁵ <http://www.pwc.com/gx/en/financial-services/publications/assets/blockchain-for-reinsurers.pdf>

⁶ European Parliament, P8_TA(2016)0228, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2016-0228+0+DOC+PDF+V0//EN>

⁷ At the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House, London, 16 June 2016, <http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech914.pdf>

⁸ Real Time Gross Settlement



In a recent speech, Christopher Woolard, Director of Strategy and Competition at the FCA, described DLT as presenting " ... *real opportunities in the regulatory space*".⁹

Currently, there is no EU or UK legislation or regulations concerning the use of DLT or VCs. In June 2016, the European Commission published a draft directive amending the 4th Anti-Money Laundering Directive that proposes, inter alia, making VC exchanges and custodian wallet providers *obliged entities* for money laundering purposes. At the time of writing, there are no proposals for prudential, or conduct regulation of VC businesses in the EU or UK.

In October 2016, the International Standards Organisation established a technical committee to develop standards for DLT.

Purpose of this consultation paper

Building on the previous work of the CWG and:

- recognising that, during 2016, DLT emerged as the predominant innovative technology expected to yield transformational benefits to the global economy, to financial and non-financial businesses, and to citizens, and
- recognising that virtual currencies are an application of DLT,

this consultation paper proposes a regulatory framework for firms using DLT, including virtual currency-related businesses.

It explores an approach that:

- provides regulatory certainty while meeting the challenge of regulating firms using nascent technology that is rapidly and continually evolving;
- permits firms to grow and adapt while ensuring it does so safely;
- protects consumers and the reputation of Gibraltar;
- leverages Gibraltar's standing as a quality financial centre;
- does not compromise the jurisdiction's robust regulatory environment;
- supports new firms seeking to startup in Gibraltar;
- encourages overseas enterprises to establish operations in the jurisdiction; and
- recognises the need for "speed to market" in the authorisation process of these firms.

Objectives

Good for Gibraltar

The main driver for proposing an innovative and bold regulatory framework for DLT activities is to encourage Gibraltar's economic development without threatening its reputation and integrity. The proposed new regulatory framework for DLT will help businesses, operating from Gibraltar, develop new products and business models, and maintain a competitive edge.

⁹ <https://www.fca.org.uk/news/speeches/our-role-promoting-innovation>



It will provide much sought-after regulatory certainty to firms and their supporting financial supply chain (banks, lawyers, accountants, professional services firms and the like). For several years, across the globe, reputable businesses engaged in VC-related activities have asked their local financial supervisors to regulate them. GFSC has been approached by several such firms.

The proposed inclusive regulatory framework for Gibraltar covers a broad scope of financially-based, DLT-related activities. Its innovative approach will avoid the pitfalls of introducing narrow-focused, highly-prescriptive regulation to a nascent technology in which new use cases and business models are still being developed.

At the same time, it is designed to help foster a fintech - and broader technology - startup culture that uniquely harnesses Gibraltar's legal, regulatory and other advantages, with the objective of drawing talent to the jurisdiction and encouraging the jurisdiction's development as a centre for excellence in DLT.

If successful, it is intended the framework could be expanded and applied to other new technologies with financial applications as well as to other innovative financial products, services and business models.

Safety and reputation

Of critical importance, the DLT framework must provide appropriate and adequate safeguards for consumers, ensure that financial crime risks are mitigated, and protect Gibraltar's reputation and integrity. It must not be treated as *regulation lite* or regarded as *soft regulation*, whilst ensuring firms are able to have a fast and proactive interaction with the regulator during this process.

HMGoG and the GFSC believe the proposed balanced approach is capable of being both good for Gibraltar and of being so without sacrificing safety. Risks identified will be assessed and measured against the GFSC's regulatory objectives.

The DLT framework will not apply to firms that are subject to regulation under any other GFSC framework.

Outline regulatory approach

The GFSC will have responsibility for the authorisation and supervision of DLT firms. In applying DLT framework principles (**DLT principles**), it is proposed that consideration be given to granting discretionary powers to the Chief Executive to set appropriate and proportionate conditions and restrictions including, without limitation, those relating to use case, business model, market, geographical exposure, product, service, size of firm, scale of operation, management experience and track record, and financial and technical risk. Such conditions and restrictions may be applied to all DLT firms, to a single firm or to groups of firms, or by category of firm, use case, business model or risk profile, or by type of product and service provided. General conditions will be supported by guidance, published as necessary, from time-to-time.

It is proposed the Chief Executive and Board be supported by a DLT specialist advisory panel comprising technology and regulation experts.



Consultation period and feedback

We welcome the views and feedback from the public or any individual, company or association interested in the proposed regulatory framework. We welcome feedback on the scope, the proposed approach, the DLT principles or any other relevant area.

We look forward to receiving your responses by 6th June 2017. This represents a 4-week consultation period.

Should you wish to have any question or require further clarification during this period please feel free to contact Paul Astengo of Gibraltar Finance at (paul.astengo@financecentre.gov.gi) or Nicholas Gomez of the GFSC at (ngomez@gfsc.gi).

HMGoG, the GFSC and the CWG will consider all responses received.

Please submit all responses to:

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Definitions

Virtual currency

Virtual currency is 'a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. “real currency,” “real money,” or “national currency”), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency - i.e., it electronically transfers value that has legal tender status.'¹⁰

Blockchain

A blockchain is a type of distributed database that maintains a continuously-growing list of ordered records that are aggregated into files (or blocks). New blocks are added to a chain of existing blocks. Each block contains a timestamp and a link to a previous block. By design blockchains are inherently resistant to modification of the data. Once recorded, the data in a block cannot be altered retroactively. Blockchains are typically, but not necessarily always, found in DLT.

Distributed ledger

A distributed ledger is a type of database that is shared across a network of multiple sites, jurisdictions or institutions. It does not have a single authoritative copy. Instead, network participants have identical copies of the ledger. A distributed ledger may employ a blockchain or other method of storing records in a continuous tamper-resistant way.

¹⁰ *Virtual Currencies: Key Definitions and Potential AML/CFT Risks*, FATF, June 2014, <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>



Scope of DLT framework

Definition of scope

It is proposed the DLT framework will apply to individuals and firms that engage in activities not subject to regulation under another framework and that, for business purposes, use DLT for the transmission or storage of value belonging to others. Activities that are subject to another regulatory framework will continue to be regulated under that framework.

Use cases and activities

Many use case ideas have been proposed for DLT, and some experiments and feasibility studies carried out. It is likely many more use cases will be suggested over coming months and years. The following is a non-exhaustive list of possible use cases for DLT.

Possible use cases

- Post-trade settlement
- Securities custody
- Trade finance
- Reference data
- Regulatory reporting
- Cross-border payments & remittances
- Mortgage loan application
- Insurance placement and contract lifecycle documentation
- Insurance claims management
- Proof of insurance
- Managing insurance policies for multinational clients
- Know-Your-Customer (KYC/AML)
- Inter-firm accounting reconciliation
- Tracking insurance policies imposing operational limits on policyholder
- Bail bond cancellation
- Excess of loss reinsurance
- Retail insurance portfolio management
- Identity management
- Companies register
- Land register
- Asset tracking
- Supply chain
- Provenance

Business activities

A few businesses, many involving virtual currencies, have started operations. The following non-exhaustive lists of actual or proposed business activities illustrate those likely to be in- or out-of-scope of the DLT framework.

In-scope examples

- Centralised VC scheme administrators (e.g. loyalty points, in-game currency)
- Holding, as a business, VC for others



- Custodian VC wallet providers
- Non-custodian VC wallet service providers
- Clearing and settlement systems
- Trading platforms
- VC exchanges (between fiat & VC, and VC-to-VC)
- Peer-to-peer VC exchange platform operators
- Remittance service providers
- B2B payment network operators
- Payment service providers
- Escrow service providers
- Issuers of asset-backed tokens
- Issuers of income distribution tokens
- Issuers of devices containing pre-loaded VC
- Issuers of VC vouchers and pre-loaded paper wallets
- Issuers of unregulated securities
- Peer-to-peer gaming platform operators
- Peer-to-peer insurance platforms.

Out-of-scope examples

- Decentralised VC schemes (e.g. Bitcoin)
- DLT software developers
- Technical services providers not controlling value belonging to others
- Users purchasing goods and services with VC
- Merchants selling goods and services with VC
- Employees receiving VC as payment of wages and salaries
- Firms paying their employees' salaries and wages in VC
- Users investing in VC for their own private purposes
- Central bank-issued digital currencies.

Financial advice

It is proposed that investment advice about virtual currencies not fall within scope of the DLT framework.

The regime for regulating the activity of giving financial advice should be applied uniformly and holistically across all asset classes and financial instruments. Separating out one financial instrument, such as VCs, may lead to anomalies with unintended consequences.

It is proposed that this new regulated activity is captured as part of the Legislative Reform Programme.

Firms regulated under another regulatory framework looking to introduce DLT

Any firm looking to introduce DLT into its business model should contact the Innovate and Create team at the GFSC or their appointed supervisor.



Overview of approach

Outcome-focused, principles-based

There is inherent difficulty in regulating activities that use rapidly-evolving technology. Regulatory measures and responses are formulated based on objective understanding of the processes employed and assessment of the risks involved. Prescriptive regulation works well for mature business activities where products, processes, business models and risks are relatively well understood.

A more flexible, adaptive approach is required in the case of novel business activities, products, and business models. Regulatory outcomes remain central but are better achieved through the application of principles rather than rigid rules. For businesses based on rapidly-evolving technology, such hard-and-fast rules can quickly become outdated and unfit for purpose.

To be effective, the process of regulating firms that are based on rapidly evolving technologies must move equally fast. The need, therefore, is to establish fundamental regulatory principles that will (1) achieve required regulatory outcomes; and (2) remain equally applicable throughout the licensing lifecycle.

DLT firms will be measured by their ability to adhere to clearly set out principles rather than rigid rules. Whatever the changing properties of the underlying technology employed, firms must be able to continuously demonstrate adherence to DLT principles.

Objective, targeted, flexible and discretionary approach

An outcome-focused, principles-based approach must be as effective in regulating novel businesses as a conventional rule-based approach is to mature, traditional businesses. It cannot be (or seen to be) a light or soft option. The application of DLT principles must therefore be objective and targeted, measurable and verifiable, and appropriate to activities performed, product, business model and risk factors.

Since each DLT firm and its activities may be unique, the DLT principles must be flexible enough to be adapted to each firm's characteristics and to its use of DLT. The Chief Executive must be able to determine the way DLT principles are applied to each DLT firm.

It is envisaged a discretionary approach will permit the Chief Executive to determine if an individual or firm is a DLT firm, subject to the DLT framework; and to set appropriate and proportionate conditions and restrictions including, without limitation, those relating to use case, business model, market, geographical exposure, product, service, size of firm, scale of operation, management experience and track record, and financial and technical risk. It is proposed that conditions and restrictions may be applied to all DLT firms, to a single firm or to groups of firms, or by category of firm, use case, business model or risk profile, or by type of product and service provided.



Rationale

The rationale for proposing a new approach is:

- To provide regulatory certainty for DLT firms based in and operating from Gibraltar;
- To provide a regulatory framework that recognises DLT is still a nascent technology that is rapidly-evolving;
- To provide a responsive regulatory framework;
- To encourage growth in technology and fintech skills in the jurisdiction.
- To provide sufficient flexibility to enable the effective regulation of novel business activities, products, processes, and business models;
- To enhance consumer confidence in dealing with properly regulated firms using novel technology;

To encourage DLT firms to be established in Gibraltar because there is an appropriate regime for regulating their activities



Desired outcomes

Three pillars

There are three pillars of desired regulatory outcomes, as follows:

Consumer Protection

Consumers of products and services provided by DLT firms operating in or from Gibraltar can have faith in the integrity of the owners and managers of those firms ensuring an appropriate degree of protection for consumers.

Protecting the Reputation of Gibraltar

GFSC facilitates and provides a progressive, well-regulated and safe environment for firms using DLT to grow whilst preserving and without endangering the good reputation of the jurisdiction.

Economic Benefit

Gibraltar prospers from the use and growth of new financial technology, expands its standing as a progressive and safe global financial centre, and attracts and retains world-class businesses and talent.



Principles

Nine DLT principles

The nine principles set out below which will be applied to DLT firms will ensure that GFSC regulatory outcomes are achieved.

1. A DLT firm must conduct its business with honesty and integrity.

The GFSC will need to be satisfied that the applicant, including the persons associated with it, are fit and proper to undertake the DLT activity. The basic elements which are relevant to such an assessment include:

- honesty, integrity and reputation
- skill, competence, care and experience
- financial position.

2. A DLT firm must pay due regard to the interests and needs of each and all its customers and must communicate with its customers in a way which is fair, clear and not misleading.

DLT firms will be expected to devote as much time and consideration to protecting consumers' interests as to their own, and dedicate sufficient resources necessary to protect consumers.

Use best endeavours to mitigate the risks associated with use of DLT and employ best practice in the operation of their business.

Make appropriate disclosures regarding:

- the use of DLT in the business;
- the risks associated with the technology and its use by firm; and
- the products and services supplied and associated risks.

Make initial and per-transaction disclosure of risks, terms and conditions, as well as employing ethical advertising and marketing standards.

Have adequate complaint policies and disclosures and be able to manage and disclose any conflicts of interest.

Ensure that the information is presented in a way that is likely to be understood by the target customer and does not disguise, diminish or obscure important items, statements or warnings.

3. A DLT firm must maintain adequate financial and non-financial resources.

DLT firms will be expected to maintain sufficient financial resources to ensure that it can be run in a sound and safe manner. Capital levels will be monitored to ensure that sufficient capital is held to support business objectives. Capital level will be commensurate with the



prudential risks. As a minimum, DLT firms will be expected to hold sufficient capital to ensure an orderly, solvent wind-down of its business. Where appropriate, DLT firms will be required to hold professional indemnity insurance cover.

Consideration will therefore be given to the:

- adequacy of financial resources;
- sustainability of business model;
- maintenance and retention of books and records; and
- audit and reporting standards.

In terms of non-financial resources, a DLT firm must ensure that it will be able to comply with the requirements imposed by the GFSC in the exercise of its functions.

4. A DLT firm must manage and control its business effectively, and conduct its business with due skill, care and diligence; including having proper regard to risks to its business and customers.

DLT firms will be expected to apply good, forward-looking risk management practices. This will help provide assurance to all stakeholders that the core processes and systems are effectively controlled, are fit for purpose and that risk is being managed in the right way.

Strong risk management practices will make DLT firms better equipped to act on risks and control in a timely manner, therefore reducing the likelihood of significant risks emerging that have not already been identified and managed effectively.

5. A DLT firm must have effective arrangements in place for the protection of client assets and money when it is responsible for them.

DLT firms will be expected to take all reasonable precautions to protect customer assets in their custody or control against unexpected eventualities and threats. Custodial assets will need to be segregated from the DLT firm's own assets.

DLT firms need to ensure that they maintain robust and accurate records of transactions.

6. A DLT firm must have effective corporate governance arrangements.

DLT firms will need to implement good corporate governance. This is crucial as it will establish the system by which firms will be run and business overseen, including its structure, processes, culture and strategies. It will establish the rules by which authority is exercised and decisions taken and implemented to manage all risk types and exposures.

DLT firms will need to deliver and maintain a corporate culture consistent with the secure and confident delivery of these principles. They will need to have an open, cooperative and transparent relationship with the GFSC and other regulators and must disclose to them any matter of which the regulator would reasonably expect notice.

Areas of focus will include:

- board structure, including composition to ensure that there is a good balance and mix of skills and experience to complement the business;



- adequate application of the *four eyes principle*; and
- application of mind and management from Gibraltar.

7. A DLT firm must ensure that all systems and security access protocols are maintained to appropriate high standards.

All systems used should ensure the right level of access to authorised personnel with up to date monitoring systems. On-going and proactive security assessments should be conducted on DLT technologies to keep up to date with any new threats and potential vulnerabilities.

These include:

- risk assessment of applications, underlying technology, and cybersecurity;
- policies, procedures and controls to ensure the delivery of this principle;
- skilled and experienced staffing;
- continuous vulnerability and threat analysis and assessment;
- continuous monitoring and response provisions; and
- independent compliance audit and reporting.

8. A DLT firm must have systems in place to prevent, detect and disclose financial crime risks such as anti-money laundering and countering terrorist financing (AML/CFT).

DLT firms must adequately apply anti-money laundering and counter terrorist financing preventive measures which are commensurate with their risks, and report suspicious transactions. DLT firms need to be aware of the vulnerabilities of its products and services to financial crime risks and ensure that they implement measures to mitigate the risks.

DLT firms will need to comply with the Proceeds of Crime Act and any guidance issued by the GFSC.

9. A DLT firm must be resilient and must develop contingency plans for the orderly and solvent wind down of its business.

DLT firms will need to develop, test and maintain adequate business continuity, disaster recovery and crisis management plans.

Preparedness for any potential threats or loss should form part of the disaster recovery plans as well as a well-managed and structured business continuity management process. Testing of the plans and its embedded processes should form part of the business model.



Application of principles

The proposed approach is not a framework for self-regulation or to be considered light or soft regulation. In determining whether a principle is met, the GFSC will have regard to similarities in such matters as risk profile, use case, business model and product. The principles will be applied proportionately and on a risk-based approach. Where similarities exist, the GFSC may apply existing regulatory provisions taken from existing regulatory frameworks, for example, apply existing conduct rules, existing capital requirements calculations, or safeguarding of assets requirements.

Guidance

DLT principles will be supplemented by guidance published by the GFSC, in advance of the operative date and from time to time thereafter. Guidance will set out what the GFSC expects and the minimum standards deemed necessary to comply with the DLT framework and meet DLT principles.

Guidance will be subject to section 24 of the Financial Services Commission Act requiring 28 days' notification.

Conditions

Due to the nature of evolving technology and DLT a granular approach will be applied to the imposition of licensing conditions, as follows:

- generally, to all DLT firms;
- to groups or categories of DLT firms including, without limitation, by category of firm, use case, business model or risk profile, or by type of product and service provided, or by characteristic of technology employed;
- to a single DLT firm.

If appropriate, where a business activity bears similarities to another regulated activity, the GFSC may apply provisions from other regulatory frameworks by way of conditions on a firm's licence if deemed appropriate and with the aim of ensuring the firm meets the DLT principles or to ensure risks are managed within the GFSC's risk appetite and tolerance.



Legislative approach

The most pragmatic and effective approach will be to incorporate the DLT framework into existing primary legislation by amending regulations under the Financial Services (Investment and Fiduciary Services) Act 1989 (the **1989 Act**).

It is proposed to make the use of DLT for the transmission or storage of value belonging to others a controlled activity within Schedule 3 of the 1989 Act. The 1989 Act already contains provisions such as licensing, power to impose licence conditions, and enforcement powers. The DLT framework will not apply to activities already regulated under any existing framework.

Relevant subsidiary legislation made under the 1989 Act will also have direct effect. Due to the nature of DLT, some regulations will necessarily be applied with modifications and others dis-applied.

Consequential amendments may be required to some provisions of the 1989 Act and to other regulations such as the Financial Services (Fees) Regulations.

This approach supports incorporation of the DLT framework into the Legislative Reform Programme.

Changes will also need to be made to the Proceeds of Crime Act to ensure that DLT firms are captured. Any supplementary regulations and guidance issued regarding AML/CFT requirements will apply to DLT firms where relevant.

Advisory panel

To assist GFSC, its Board and Chief Executive, it is proposed to form an advisory panel, appointed by the Minister with responsibility for Financial Services, comprising technology and regulation experts in the field of DLT and virtual currencies.

The panel should have a deep knowledge and understanding of individual components of DLT including, without limitation, consensus technologies, cryptography, security, and financial crime.

The role of the panel will include advising HMGOG of developments in DLT and, particularly, changes in risks, threats and vulnerabilities. The panel will initially convene as and when required.

The panel may report on its own initiative, or in response to general or individual references made by the Chief Executive or Board, for example, about an application by a firm with a new and untried business activity, use case, business model or application of technology.

The Advisory Panel will also serve to educate GFSC staff members so that we can continue to develop expertise in this area. Timeline

Subject to the results of the consultation and the advice of the GFSC and the CWG, HMGOG will consider all matters arising and prepare the necessary legislation during summer of 2017.

The GFSC will start identifying operationalisation and internal training requirements and begin drafting initial general conditions and guidance during summer 2017, once HMGOG has decided to proceed with legislative change, with documentation ready for publication in the last quarter of 2017. The proposed operative date for the DLT framework is 1 January 2018.



Resources

Additional HR resources required by the GFSC to prepare detailed proposals, and guidance. These resources include a subject-matter expert, a full-time regulatory technician and time spent by members of GFSC's Innovate and Create Team.

It is envisaged that this will be funded by the GFSC from existing financial resources.

The costs of authorisation, supervision and enforcement will be met from DLT licence income.