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GUIDE TO
BERMUDA'S DIGITAL
ASSET BUSINESS
REGULATORY
REGIME



BEESMONT

BERMUDA'S DIGITAL ASSET BUSINESS REGULATORY REGIME

Bermuda successfully launched the Digital Asset Business Act (**DABA**) in 2018 which established the foundation for a comprehensive legislative and regulatory framework designed to support and facilitate growth in the financial technology (**Fintech**) sector.

Regulation of Digital Asset Business

DABA 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.

DABA defines 'digital asset business' as the business of providing any or all of the following digital asset business activities to the general public:

- issuing, selling or redeeming virtual coins, tokens or any other form of digital asset;
- operating as a payment service provider business utilising digital assets which includes the provision of services for the transfer of funds;
- operating as a digital asset exchange (centralized or decentralized electronic marketplace used for digital asset issuances, distributions, conversions and trades, including primary and secondary distributions, with or without payment; provided that digital asset conversions and trades may also be entered into by the electronic marketplace as principal or agent);
- carrying on digital asset trust services (acting as a fiduciary, agent, or trustee on behalf of another person for the purpose of administration and management of a digital asset);
- providing custodial wallet services (storing or maintaining digital assets or a virtual wallet on behalf of a client);
- operating as a digital asset derivative exchange provider (a centralized or decentralized marketplace used for digital asset derivatives issuances, distributions and trades with or without payment; provided that digital asset derivatives trades may also be entered into by the marketplace as principal or agent);
- operating as a digital asset services vendor (includes a person that under an agreement as part of its business can undertake a digital asset transaction on behalf of another person, has power of attorney over another person's digital asset, operates as a market maker for digital assets or operates as a digital asset benchmark administrator), where:
 - a 'market maker' includes any operator who is (i) fulfilling digital asset trade orders initiated by, or in response to, clients' requests for trades, or (ii) hedging positions arising from quoting trade prices or fulfilling trade orders of digital assets;
 - a 'digital asset benchmark administrator' includes any person that has control over the provision of a digital asset benchmark including administering the arrangements for determining a benchmark, collecting, analysing or processing input data for the purpose of determining a benchmark, and determining a benchmark through the application of a formula or other method of calculation or by an assessment of input data provided for that purpose; or
- operating as a digital asset lending or digital asset repurchase transactions service provider (a person facilitating transactions by which a counterparty transfers or lends digital assets to a borrower subject to a commitment that the borrower will return equivalent digital asset with or without interest or premium on a future date; or when requested to do so by the lender or transactions governed by an agreement by which a counterparty transfers digital assets to a counterparty subject to a commitment to repurchase them or substituted digital assets of the same description at a specified price with or without premium, on a future date specified, or to be specified from that counterparty either as principal or agent).

A 'digital asset' under DABA means anything that exists in binary format and comes with the right to use it and includes a digital representation of value that:

- is used as a medium of exchange, unit of account, or store of value and is not legal tender, whether or not denominated in legal tender;
- is intended to represent assets such as debt or equity in the promoter;
- is otherwise intended to represent any assets or rights associated with such assets; or
- is intended to provide access to an application or service or product by means of distributed ledger technology.

There are substantial penalties under DABA for anyone who fails to comply with any requirement or contravenes any prohibition imposed by or under the legislation, including potential fines of up to \$10,000,000. In addition the Authority has a wide range of enforcement options available to deal with any failure to comply with prudential and AML/ATF (Anti-Money Laundering and Anti-Terrorist Financing) requirements.

Licensing of Digital Asset Business

DABA 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 DABA¹.

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 by the Authority pursuant to DABA. A detailed comprehensive digital asset business application must be submitted to the Authority in the appropriate form and must state the class of digital asset business licence required. There are three classes of digital asset business licences which may be applied for as follows:

- **Class F (full) 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;
- **Class M (modified) 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; or

- **Class T (test) licence**, under which a person shall be licensed to provide any digital asset business activity under the definition of digital asset business, for a defined period determined by the Authority and for the purpose of carrying out pilot or beta testing in relation to such activity.

Application Process

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 (or explanation for the any omissions);
- copies of the constitutional documents;
- a business plan dealing with key items, such as:
 - ownership of the applicant, including identification of its ultimate parent and other relevant details of its group organisational structure;
 - information, including curriculum vitae, on the applicant's board of directors, and senior management;
 - description of the applicant's business purpose for licensing in Bermuda, outlining the rationale for Bermuda as the chosen jurisdiction;
 - business strategy and risk appetite;
 - insurance details and description of mitigation;
 - financial assessment;
 - explanation of how the applicant plans to meet head office requirements;
 - projections of staffing requirements; and
 - 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;

¹ Currently, one exemption order has been issued, under which the Authority, Government of Bermuda and any entity owned by either of them or a public authority are exempt as well as persons who provide an affinity/rewards programme, issue digital representations used within an online game, provide data storage or security services, undertake such business solely for group business operations as well as investment funds.

- 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 node access or other arrangements 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 DABA.

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; and
- copies of the most recent statutory financial statements and/or any other relevant financial information.

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 for licensing

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.

Protection of client assets

Licensed undertakings are required to keep client assets separately from other business assets. Also licensed undertakings must maintain a trust account, surety bond or indemnity insurance to protect clients and maintain sufficient amount of each type of digital asset in order to meet client obligations.

There are also requirements for a licensed undertaking to appoint a Senior Representative (a person who shall be required to make disclosures to the Authority, such as non-compliance by the licensed undertaking).

Other Technical, Prudential and Compliance standards

The digital asset business regulatory framework also encompasses:

- A Code of Practice and Statement of Principles, which provide guidance on the overarching duties and standards to be observed by licensed undertakings and how the Authority conducts supervision;
- Various prudential standards including the Client Disclosure rules (specifying mandatory disclosures to be made to customers) and

Annual Return Rules, pursuant to which licensed undertakings shall file an annual return 2018;

- Rules in respect of cybersecurity (comprising the Cybersecurity Rules² and the Cyber Risk Code) as well as the technical standards in respect of the custody of digital assets and in particular management of client private keys and wallets; and
- Guidance notes in respect of AML/ATF obligations applicable to DABA licensed undertakings (as regulated financial institutions supervised by the Authority), including notes specific to the digital asset business sector.

Substantive obligations on licensed undertakings include, in respect of AML/ATF obligations:

- 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's entity type or a customer's nature of business or occupation.
- 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.

In respect of cybersecurity, obligations under the Digital Asset Business (Cybersecurity) Rules 2018 (**Cybersecurity Rules**) include:

- Filing of an annual cybersecurity 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 cybersecurity programme implemented and proposals for steps for the redress of any inadequacies identified.
- Operating a cybersecurity programme which includes penetration testing of its electronic systems and vulnerability assessment of those systems conducted at least on a quarterly basis and audit trail systems that—
 - track and maintain data that allows for the complete and accurate reconstruction of all financial transactions and accounting;
 - protect the integrity of data stored and maintained as a part of the audit trail from alteration or tampering;
 - 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;
 - log system events including but not limited to access and alterations made to the audit trail systems, and Cybersecurity Events; and
 - maintain records produced as part of the audit trail.
- Engaging a qualified independent party to audit its systems and provide a written opinion to the Authority,

as well as additional technical obligations pursuant to the Digital Asset Business Operational Cyber Risk Management Code of Practice and the Digital Asset Custody Code of Practice.

From 1 January 2024 the Cybersecurity Rules will be replaced by the Digital Asset Business (Cyber Risk) Rules 2023 which will require annual returns be made by Class F Licensees (and Class M and T licensed undertakings shall file returns on dates determined by the Authority).

In addition to these compliance measures, every licensed 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.

Ancillary Activities (Investment Business)

In 2022, DABA licensees were included in a category of “Non-registrable person” under the Investment Business Act 2003 (**Investment Business Act**) permitting such licensees to carry on investment business which is ancillary to such licensed digital asset business without having to obtain a license or register under the Investment Business Act (where they would otherwise be required to do so). A corresponding amendment to DABA requires the senior representative of a licensee to notify the Authority if the licensee ceases to be eligible for such exemption from licensing under the Investment Business Act where the investment business being carried out is no longer ancillary to the digital asset business (for which it has a licence pursuant to DABA).

The Authority also published guidance notes specifying the criteria for determining whether investment activities are ancillary, including by reference to the gross revenue generated from the activities which fall within scope for licensing under the Investment Business Act as a proportion of the total revenue from all activities which fall within the ambit of DABA and the Investment Business Act. Entities which are subject to the ancillary exemption are subject to additional reporting requirements and would be required to file a material change notification where the new products constituting the investment business would result in a change in the business plan of the DABA licensee.

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If you have any queries on the revised IBA regime and its applicability, then please do not hesitate to contact the BeesMont team members below who are able to assist with your queries or your usual contact at BeesMont.

KEY CONTACTS

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Bourn advises on a wide range of local and international corporate and regulatory matters, with experience in banking and finance, debt capital markets, and structuring transactions.

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