



MALTA - ICOs
THE NEW LEGISLATION

2018

| Contents | Page |
|---|-------------|
| A. INTRODUCTION..... | 2 |
| B. TO WHOM DOES THE NEW LAW APPLY?..... | 2 |
| C. DEFINITION OF VIRTUAL FINANCIAL ASSET (VFA)..... | 3 |
| D. ISSUING OF A VFA – REQUIREMENT OF A WHITEPAPER | 5 |
| E. APPOINTMENT OF A VFA AGENT | 5 |
| F. ADVERTISMENT..... | 6 |
| G. ADMISSION TO TRADING ON A VFA EXCHANGE | 6 |
| H. DUTIES OF THE ISSUER | 7 |
| I. DUTIES UNDER ANTI-MONEY LAUNDERING LAWS | 8 |
| J. CERTIFICATE OF COMPLIANCE | 8 |
| K. PREVENTION OF MARKET ABUSE | 8 |
| L. CORPORATE TAXATION | 9 |
| M. TRANSITORY PROVISIONS..... | 9 |
| N. CONCLUSION | 10 |
| O. ANNEX I – FORMAT AND CONTENTS OF WHITEPAPER | 10 |

A. INTRODUCTION

Initial Coin Offering, known as “ICO”, is a relatively new phenomenon that has quickly become the main player in the Financial Services and Crowdfunding industries, as well as being the key subject of discussion in the Blockchain communities. In essence, it is one of the most advanced methods of raising finance from the public and is becoming increasingly popular to fundraise start-ups.

While all jurisdictions are shying away from regulating this industry, Malta has recently introduced a specific regulatory framework for ICOs and has become the first jurisdiction worldwide to regulate ICOs and Blockchain Technology.

This publication in fact seeks to give an overview of the recent laws and regulations relating to ICOs.

Information relating to any ancillary services to cryptocurrencies, including the operation of platforms to exchange such cryptocurrencies, portfolio management and providing investment advice amongst others, is discussed in our brochure: **“Malta – Virtual Financial Asset Services – The New Legislation”**.

B. TO WHOM DOES THE NEW LAW APPLY?

The new legislation applies to anyone who will offer to the public Virtual Financial Asset(s) (VFA) as these are defined in the new legislation. Hence, if the asset that is offered to the public is not a VFA, the new legislation does not apply.

In order for a person to issue a VFA, the following must be met:

1. A Whitepaper, must be drafted, which must be approved and registered at the Malta Financial Services Authority (MFSA);
2. To have at all times a VFA Agent, duly authorised by the MFSA.

At this stage, it is crucial to point out that as of the time of the publication of this brochure, the new legislation and relevant rules of the MFSA are still in draft form.

C. DEFINITION OF VIRTUAL FINANCIAL ASSET (VFA)

By way of a definition, a VFA is 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 one of the following as defined below:

1. Electronic Money;
2. Financial Instrument; and
3. Virtual Token.

Legal definitions of the above:

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 (as defined) and which is accepted by a natural or legal person other than the financial institutions that issued the electronic money.

Financial Instrument includes the following:

- Transferable securities, including shares and bonds;
- Money market instruments such as treasury bills and certificates of deposit;
- Units in a collective investment scheme;
- Options, futures, swaps and any other derivative contracts relating to securities, currencies interest rates, yields, commodities or those that are traded on a regulated market etc.;
- Derivative instruments for transfer of credit risk;
- Rights under a contract for difference;
- Instruments which confer property rights;

- Foreign exchange held for investment purposes; and
- Emission allowances under EU Emissions Trading Scheme.

Virtual Tokens have been defined as a form of digital medium recordation that:

- a. has no utility, value or application outside of the DLT platform on which it was issued; and
- b. may only be redeemed for funds on such platform directly by the issuer of such DLT asset.

Electronic money is excluded from this definition.

The MFSA is proposing a compulsory *Financial Instrument Test* in order to determine whether an asset is a Financial Instrument or not.

The process is a two-fold test, being:

1. Does the VFA qualify as a Virtual Token as defined under the new laws? If it does, having in mind its restricted definition as per the new laws herein specified, then it is exempted under the new VFA Law and the licencing requirements do not apply.
2. If it is not qualified as a Virtual Token, then one has to determine whether this qualifies as a Financial Instrument under MiFID (Section C, Annex 1) considering all the categories of Financial Instatements as identified above. If the answer is negative, then the asset is caught under the VFA Law and its licensing procedure must be followed.

In summary

If a cryptocurrency qualifies as a Virtual Token as defined in the new law and does not qualify as a Financial Instrument or Electronic Money, then it is exempted from

the ambit of applicability of the new law and the licensing requirements are not needed for its issuing or trading.

D. ISSUING OF A VFA – REQUIREMENT OF A WHITEPAPER

The new law prescribes that a whitepaper which will be registered and in effect approved by MFSA is compulsory in order for an issuer to:

1. Offer a VFA to the public in or from within Malta; or
2. Apply for a VFA's admission on a Distributed Ledger Technology (DLT) Exchange.

Ten days before being circulated, the whitepaper has to be:

1. Signed by every director of the issuer; and
2. Signed by the duly appointed VFA agent; and
3. Delivered to the MFSA, which shall register the whitepaper if it is satisfied that the requirements have been duly complied with.

Most importantly, the whitepaper shall have the contents specified in Annex I of this publication. Non-observance with any of such requirements will automatically disqualify the whitepaper from being registered / approved.

E. APPOINTMENT OF A VFA AGENT

An issuer of a VFA is required to appoint, and have at all times in place, a VFA agent who is duly registered with the MFSA. The VFA Agent must at all times remain independent from the issuer.

The roles of the VFA Agent shall include the following:

- Ensure that the issuer has satisfied all requirements of the laws;

- Ensure that the issuer is a fit and proper person to carry out the relevant activities;
- Advise the issuer on its responsibilities and obligations of the law;
- Submit all required documentation, information and explanations to the MFSA;
- Act as a liaison between the issuer and the MFSA in all matters in connection to the whitepaper or the trading of the issuer's VFA on a DLT exchange;
- Submit to the MFSA on behalf of the issuer an annual certificate of compliance;
- Provide a declaration of independence from the issuer to the MFSA.

F. ADVERTISEMENT

If the issuer maintains a website, its homepage shall contain such information and in such a format as may be required by the MFSA by means of duly published Rules.

Any type of advertisement that relates to an initial VFA offering or the admission of a VFA to trading on a DLT exchange, shall satisfy the following:

- Adverts shall be clearly identifiable as such, and must not be inaccurate or misleading.
- Information must be consistent with the contents of the whitepaper.
- Advert must contain a statement that a whitepaper has been / will be duly published in accordance to the law.

G. ADMISSION TO TRADING ON A VFA EXCHANGE

A person can apply for admission of its VFA to trading on a VFA exchange. This application can only be made through a VFA Agent.

Such an admission has to be made in accordance with the Rules duly published by the MFSA.

However, it is important to keep in mind that the offering of VFAs, or the admission to trading on a DLT exchange, in a country outside Malta shall be subject to the laws of that country.

H. DUTIES OF THE ISSUER

By law, the issuer shall:

- conduct its business with honesty and integrity;
- communicate with his investors in a fair, clear and not misleading manner;
- conduct its business with due skill, care and diligence;
- identify and manage any conflict of interest that may arise;
- have effective arrangements in place for the protection of investors' funds;
- have effective administration arrangements;
- maintain all of its systems and security access protocols to appropriate international standards; and
- be considered as a subject person in terms of the anti-money laundering regulations.

In addition, the issuer shall be liable for damages sustained by a person as a direct consequence of such person having bought Virtual Financial Assets, either as part of an initial VFA offering by such issuer or on a DLT exchange, on the basis of information contained in the whitepaper, website or advertisement by reason of any untrue statement included therein.

The law also specifies that a statement in the whitepaper or advertisement shall be deemed to be untrue if it is misleading, inaccurate or inconsistent, either wilfully or in consequence of gross negligence.

I. DUTIES UNDER ANTI-MONEY LAUNDERING LAWS

By law, the issuer shall be considered a Subject Person in terms of the Anti-Money Laundering laws.

In essence, this implies that the issuer has to:

- Have adequate procedures and systems to detect and combat money laundering and financing of international terrorism;
- Appoint a qualified Money Laundering Reporting Officer;
- Perform customer due diligence;
- Monitor transactions;
- Conduct periodical risk assessment on the clients;
- Submit suspicious transaction reports to the relevant authorities.

J. CERTIFICATE OF COMPLIANCE

The issuer shall be required to submit on an annual basis a certificate of compliance to the MFSA.

The certificate will confirm that the issuer is compliant with all the relevant obligations laid down by law.

K. PREVENTION OF MARKET ABUSE

The following prohibitions apply to acts carried out by any person concerning VFA that are admitted to trading on a VFA exchange:

- Prohibition of insider dealing or recommending or inducing another person to engage in such insider dealing;
- Prohibition of unlawful disclosure of inside information;

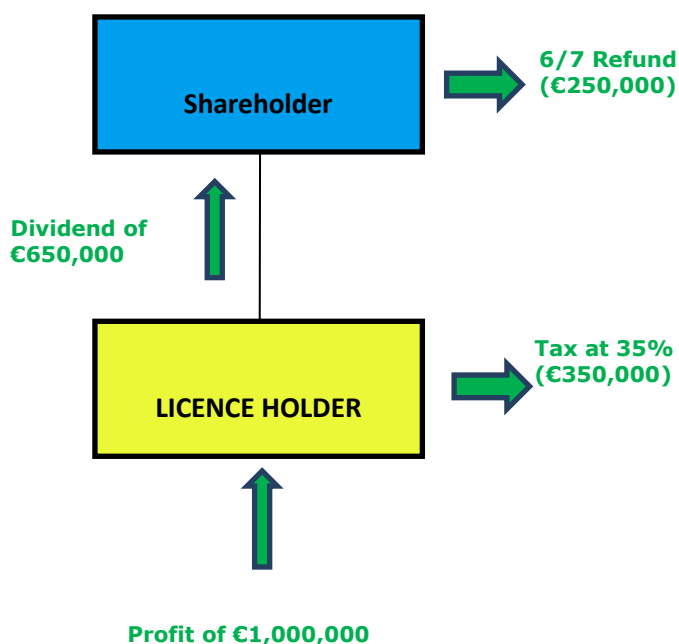
- Prohibition of market manipulation.

It shall also be mandatory for the VFA Exchange to have effective systems, procedures and arrangements to monitor and detect market abuse.

L. CORPORATE TAXATION

As a company resident in Malta, a Licence holder may also benefit from the advantageous fiscal treatment wherein a shareholder may apply for refunds equivalent to 6/7th of the income tax paid at corporate level, leaving the tax leakage to a maximum of **5%** on company profits.

The above is explained in the following basic graphical representation :



The structure to the left will feature the following –

- Licence Holder generates €1m in profit in a year;
- Malta Tax of 35% on this income will apply;
- Upon a distribution of dividends, the shareholder may claim a 6/7th refund of Malta tax paid by the Licence Holder;
- No Malta tax is imposed on the dividend;
- No Malta withholding tax on dividends;
- Malta Tax leakage – maximum of 5%.

M. TRANSITORY PROVISIONS

Any person who is conducting any regulated activity is required to comply with the new laws once they come into force. The laws provide a stipulated time-frame

of **six months** for a person involved in Initial VFA offering draw up a whitepaper and register it with the MFSA. It has been also clarified that such a person may continue to undertake this activity or provide such service until the whitepaper has been registered with, or the application has been determined by the Authority.

N. CONCLUSION

ICOs are an innovative and quick method for companies to raise capital. This new method requires ad hoc regulations, in order to maximize efficiency and investor protection. Via the introduction of the new regulations, Malta has become the first jurisdiction in the world to have specific laws on this, and this will render the island the natural choice of jurisdiction for ICO issuing companies.

One has to always proceed with caution, as there are various laws that might need to be taken into consideration before proceeding with an ICO. Hence, classification of the Token is of paramount importance. Additional legal issues might arise and hence need to be considered if an ICO targets investors globally.

Regardless of the Token structure and its classification, the issuing company needs to provide investors with full, genuine, correct and detailed information and disclose such information comprehensively and transparently to permit an average investor to make a reasonable investment decision.

Non-compliance with any of the above may result in severe legal consequences to the ICO issuer.

To this effect, it is highly advisable that all ICO intended issuers seek proper legal advice and guidance at all stages of an ICO. With such guidance and professional advice, an ICO may become a solid valuable method of financing companies and give a boost to innovative technology and infrastructure.

O. ANNEX I – FORMAT AND CONTENTS OF WHITEPAPER

The whitepaper shall contain the information which, according to the particular nature of the issuer and of the Virtual Financial Assets (VFA) offered to the public, is necessary to enable investors to make an informed assessment of the prospects of the issuer, the proposed project and of the features of the VFA.

This information must be presented in an easily analysable and comprehensible form.

It must be drafted in English language and any or no additional languages.

By law, and under penalty of rejection by the MFSA, the whitepaper must contain the following information:

1. Date;
2. Statement that the whitepaper complies with the requirements of the Maltese law;
3. Summary:
 - a. The whitepaper shall contain a summary that in brief and non-technical language shall provide key information in relation to the offering, and essential elements of the VFA concerned in order to aid the investors when considering whether to invest in such VFA;
 - b. The summary shall include a warning that states that:
 - i. it should be read as an introduction to the whitepaper;
 - ii. any decision to invest in the VFA should be based on consideration of the whitepaper as a whole by the investor;

- iii. the offering of VFA does not constitute an offer or solicitation to sell financial instruments and that any such offer or solicitation of financial instruments will be made only by means of a prospectus or other offering documentation in terms of any applicable Maltese law;
- iv. civil liability attaches to those persons who have tabled the summary including any translation thereof and applied for its notification.

4. Specific matters to be included:

- a. Names, functions and declarations by the persons responsible for the whitepaper that to the best of their knowledge the information contained in the whitepaper is in accordance with the facts and that the whitepaper makes no omission likely to affect its import.

5. Offer to the public – the following information must be included in the whitepaper:

- a. description of the reason behind the initial VFA offering;
- b. detailed technical description of the protocol, platform and/or application, as the case may be and the associated benefits;
- c. detailed description of the sustainability and scalability of the proposed project;
- d. associated challenges and risks as well as mitigating measures thereof;

- e. detailed description of the characteristics and functionality of the VFA being offered;
- f. detailed description of the issuer, VFA agent, development team, advisors and any other service providers that may be deployed for the realisation of the project;
- g. detailed description of the issuer's wallet/s used;
- h. description of the security safeguards against cyber threats to the underlying protocol, to any off-chain activities and to any wallets used by the issuer;
- i. detailed description of the life cycle of the initial VFA offering and the proposed project;
- j. detailed description of the past and future milestones and project's financing;
- k. detailed description of the targeted investor base;
- l. exchange rate of the VFA;
- m. description of the underlying protocol's interoperability with other protocols;
- n. description of the manner funds raised through the initial VFA offering will be allocated;
- o. the amount and purpose of the issue;
- p. the total number of VFA to be issued and their features;
- q. the distribution of VFA;
- r. the consensus algorithm, where applicable;
- s. incentive mechanism to secure any transactions, transaction and/ or any other applicable fees;
- t. in the case of a new protocol, the estimated speed of transactions;
- u. any applicable taxes;
- v. any set soft cap and hard cap for the offering;
- w. the period during which the offer is open;
- x. any person underwriting or guaranteeing the offer;

- y. any restrictions on the free transferability of the VFA being offered and the DLT exchange/s on which they may be traded, to the extent known by the issuer;
- z. methods of payment;
- aa. specific notice that investors participating in the initial VFA offering will be able to get their contribution back if the soft cap is not reached at the end of the offering and detailed description of the refund mechanism, including the expected time-line of when such refund will be completed;
- bb. detailed description of the risks associated with the VFA and the investment therein;
- cc. the procedure for the exercise of any right of pre-emption;
- dd. detailed description of the smart contract/s, if any, deployed including inter alia the adopted standards, its/their underlying protocol/s, functionality/ies and associated operational costs;
- ee. if any smart contract/s is/are deployed by the issuer, details of the auditor who performed an audit on it/them;
- ff. description of any restrictions embedded in the smart contract/s deployed, if any, including inter alia any investment and/or geographical restrictions;
- gg. the program agents used to obtain data and verify occurrences from smart contracts (also known as 'oracles') used and detailed description of their characteristics and functionality thereof;
- hh. bonuses applicable to early investors including inter alia discounted purchase price for VFA;
- ii. the period during which voluntary withdrawals are permitted by the smart contract, if any;
- jj. description of the issuer's adopted white-listing and anti-money laundering and counter financing of terrorism procedures in terms of the Prevention of Money Laundering laws and regulations;
- kk. intellectual property rights associated with the offering and protection thereof; and

- II. the methods and time-limits for delivery of the VFA - Provided that the MFSA shall have the power to waive or modify any of the above requirements within the context of a particular initial VFA offering or a particular application for admission to trading on a DLT exchange, as the case may be.

6. Details of the Issuer:

- a. Name;
- b. Registered Address and Registration Number;
- c. Date of Registration;
- d. The issuer's object/s;
- e. Where applicable, the group of undertakings to which the issuer belongs;
- f. Insofar as they are known, indication of the members who directly or indirectly exercise or could exercise a determining role in the issuer's administration;
- g. Description of the issuer's principal activities including the disclosure of any legal proceedings having an important effect on the issuer's financial position;
- h. Names, addresses and functions of board of administrators of the issuer;
- i. Where the issuer has been established for a period exceeding three years, details of its financial track record.

7. Third party benefits and expenses:

- a. The amount or estimated amount of preliminary expenses and the persons by whom any of those expenses have been paid or are payable, and the amount or estimated amount of the expenses of the issue and the persons by whom any of those expenses have been paid or are payable.

- b. Any amount or benefit intended to be paid or given to the VFA agent or any person endorsing the offering, and the consideration for the payment or the giving of the benefit.

8. Significant new factors, material mistakes, inaccuracies:

- a. Every significant new factor, material mistake or inaccuracy relating to the information included in the whitepaper which is capable of affecting the assessment of the VFA and which arises or is noted between the time when the whitepaper is approved and the final closing of the offer to the public, whichever occurs later, shall be mentioned in a supplement appended to the whitepaper. Such a supplement shall be approved in the same way and published in accordance with at least the same arrangements as were applied when the original whitepaper was published. The summary, and any translations thereof, shall also be supplemented, if necessary, to take into account the new information included in the supplement.
- b. Investors who have already agreed to purchase or subscribe for the VFA before the supplement is published shall have the right to withdraw their acceptance within two working days after the publication of the supplement, provided that the new factor, mistake or inaccuracy referred to in paragraph (a) arose before the final closing of the offer to the public and the delivery of the VFA. That period may be extended by the issuer in which case the smart contract, if any, shall be updated accordingly. The final date of the right of withdrawal shall be stated in the supplement.

Disclaimer

This publication has been prepared as a general guide and for information purposes only. It is not a substitution for professional advice. One must not rely on it without receiving independent advice based on the particular facts of his/her own case. No responsibility can be accepted by the authors or the publishers for any loss occasioned by acting or refraining from acting on the basis of this publication.

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The Firm

Kinanis Fiduciaries Limited is a Maltese corporate service provider specializing in corporate and tax advice excelling in providing the international investor with a one-stop-shop solution in doing business through Malta.

Our Services

- Company Incorporations & Management
- ICO consulting
- VFA Agent Services only once and upon receipt of the relevant licence
- Taxation
- Accounting & VAT
- Aircraft, Ship and Yacht Registration
- Trusts Formation
- Investment Fund Licence Application & Set Up
- Remote Gaming Licence Applications
- Intellectual Property
- Opening & Management of Bank Accounts

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