

**MALTA - VIRTUAL FINANCIAL ASSET SERVICES
THE NEW LEGISLATION**

2018

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A. INTRODUCTION

Blockchain technology has revolutionized the way of doing business globally. In fact, similar to Investment Services, a number of ancillary business activities are now connected to the industry, ejecting the Blockchain technology to endless fields of everyday life.

Instead of shying away from the technological challenge, the Maltese government has adopted legislation that regulates the offering of certain services (known as Virtual Financial Asset Services) to cryptocurrencies, which includes the operation of platforms to exchange such cryptocurrencies, portfolio management and providing investment advice amongst others. This makes Malta a pioneer in this sector and offers legal certainty, to such an extent that following such a commitment from the Government, crypto-giants are already relocating to Malta, seeking to benefit from a regulated environment and a beneficial tax rate.

This publication in fact seeks to give an overview of the recent laws and regulations relating to the Virtual Financial Asset Services (i.e. VFA Services).

The scope of this brochure is restricted to VFA Services. Information relating to Initial Coin Offering (ICOs) is discussed in our brochure: **"Malta – ICOs – The New Legislation"**.

B. TO WHOM DOES THE NEW LAW APPLY?

The legislation applies to any person who intends to provide a Virtual Financial Asset (VFA) Service in or from within Malta.

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

1. A Licence, which is duly issued by 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. DEFINITION OF VIRTUAL FINANCIAL ASSET SERVICE

In order to determine whether the relevant service is regulated, one has to analyse the definition of a VFA Service. This is crucial to determine the requirement or otherwise of a licence.

VFA Services have been defined by the legislation as being:

- **Reception and transmission of orders** - The reception from a person of an order to buy, sell or subscribe for virtual financial assets and the transmission of that order to a third party for execution;
- **Execution of orders on behalf of other persons** - Acting to conclude agreements to buy, sell or subscribe for one or more virtual financial assets on behalf of other persons;
- **Dealing on own account** – Trading by using own funds to conclude transactions in one or more virtual financial assets;
- **Portfolio Management** – Managing assets belonging to another person if such assets include a VFA or the manager has discretion to invest any of the assets in a VFA;
- **Custodian or Nominee Services** of a VFA or private cryptographic key;
- **Investment Advice** and recommendations to buy / sell / subscribe for / exchange / redeem etc. to potential investors in connection to a VFA;
- **Placing of VFA** - The marketing of newly-issued VFA or of virtual financial assets which are already in issue but not admitted to trading on a DLT

exchange, to specified persons and which does not involve an offer to the public or to existing holders of the issuer's virtual financial assets;

- **Operation of a VFA Exchange.**

E. LICENCE APPLICATION

The following are the basic steps that need to be satisfied by a prospective applicant in order to apply for a VFA Service licence from the MFSA:

1. Appointment of a VFA Agent

The first step in applying for the licence is to appoint a VFA Agent, who must be duly registered with the MFSA.

In fact, applications for licence shall be made **solely** through a VFA agent and the VFA Agent shall only submit the relevant application to the MFSA if it is satisfied that the applicant is fit and proper to provide the VFA Services.

The roles of the VFA Agent shall include the following:

- Ensure that the applicant has satisfied all requirements of the laws;
- Ensure that the applicant is a fit and proper person to carry out the relevant activities;
- Advise the applicant on its responsibilities and obligations at law;
- Submit all required documentation, information and explanations to the MFSA;
- Act as a liaison between the applicant and the MFSA;
- Submit to the MFSA on behalf of the issuer an annual certificate of compliance;
- Provide a declaration of independence from the applicant to the MFSA.

It is important to state that the applicant must maintain a VFA Agent at all times throughout the period in which he holds a licence.

2. Contents of the Application Form

By law, as a minimum, the application must contain:

- The application form as prescribed by the MFSA;
- An address in Malta for service of any notice;
- A programme of operations setting out systems, security access protocol and other matters as may be duly required;
- The fee as prescribed by the MFSA (Please see Annex I attached).

3. Criteria that Need to be Satisfied

In order for the MFSA to issue a licence, it must be satisfied on an on-going basis that:

- The applicant has a duly appointed **VFA Agent**;
- The applicant is a **fit and proper** person to provide the VFA services. This test is conducted on all the beneficial owners, directors and managers of the entity. This is typically done via the submission of detailed Personal Questionnaires on the owners and directors;
- The applicant will **comply with the regulations**;
- If applicant is a natural person, such person has to be **resident** in Malta;
- If applicant is a legal person, it must:
 - Be **constituted** in Malta or if it is constituted outside Malta, must establish a branch in Malta;
 - **Limit its business activities** to that of a VFA Service. Otherwise, it might be required to establish a separate entity for businesses not compatible with the VFA services.

- The applicant must satisfy any other **licensing conditions** that the MFSA might deem fit to impose from time to time;
- The applicant must satisfy to the MFSA that it will:
 - Protect the investors and the general public;
 - Protect the reputation of Malta;
 - Promote the innovation, competition and choice.

4. Officers to be Appointed

The following are required by law to be appointed by the applicant:

- A **board of administration** consisting of **administrators**;
- An **officer** to safeguard customers' VFA and related compliance;
- A **systems' auditor** of innovative technology arrangements and related smart contracts;
- **MLRO** (Money Laundering Reporting Officer) in line with the anti-money laundering regulations.

5. Grounds for Refusal to Grant Licence

The MFSA shall refuse to grant a licence in any of the following circumstances:

- Application is not submitted in accordance with the established procedure;
- Relevant fees are not paid;
- Applicant submits false, misleading, inaccurate or incomplete information to MFSA;
- MFSA is not satisfied that the applicant:
 - Is fit and proper;
 - Has sound and prudent management;
 - Has a robust administration arrangement and adequate internal control mechanism;
 - Can properly exercise effective supervision;

- Can comply with all regulatory requirements.
- The granting of the licence to the applicant may pose a risk to investors;
- The applicant does not submit the information as duly requested by the MFSA.

6. Payment of Fees

The applicant will pay the relevant fees to the MFSA, as indicated in Annex I attached.

7. Nature of the Licence

The granting of a licence is a concession and a revocable right. By law, no holder of such a licence shall be deemed to have acquire any vested rights therein.

No licence and no holding or beneficial ownership in a licence holder may be assigned or transferred without the prior written consent of the MFSA. Any such transfers before the consent shall be considered null and void and constitute sufficient grounds for the MFSA to cancel the licence.

Once granted a licence, the holder thereof shall be subject to fiduciary obligations towards its customers. It is important to keep in mind that the MFSA reserves the general power to cancel or suspend any licences.

F. TYPES OF LICENCES

The MFSA has total and sole discretion to classify the applicant into one of the following categories of licences:

LICENCE	ACTIVITY
CLASS 1	Licence holders authorized to perform any of the following: <ul style="list-style-type: none"> • receive and transmit orders; and/or • provide investment advice in relation to a VFA; and/or • placing of VFA
CLASS 2	Licence holders authorized to perform any of the following: <ul style="list-style-type: none"> • any VFA service and • hold or control clients' money but NOT to: <ul style="list-style-type: none"> • operate a VFA exchange or • deal for their own account
CLASS 3	Licence holders authorized to perform any of the following: <ul style="list-style-type: none"> • any VFA service and • hold or control clients' money but NOT to: <ul style="list-style-type: none"> • operate a VFA exchange
CLASS 4	Licence holders authorized to perform any of the following: <ul style="list-style-type: none"> • operate a VFA exchange and • hold or control clients' money, virtual VFA and private cryptographic keys; and • custodian / nominee services for activities solely relating to the such VFA exchange

G. BOARD OF ADMINISTRATION

By law, the licence holder must appoint a Board of Administration that shall be vested with the responsibility to abide by all requirements under Maltese law.

The Board of Administration must at all times:

- be of good repute;
- possess sufficient collective knowledge, skills and experience;
- commit sufficient time to perform their duty;
- clearly understand the licence holder's activities and risks involved;
- devote adequate human and financial resources to the training of its board.

The licence holder shall have to satisfy to the MFSA that the number of positions as administrators held by a member of its board of administration at the same time are feasible after taking into consideration the nature, scale and complexity of the licence holder's activities.

Each member of the board of administration shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary.

H. ADVERTISEMENT

If the licence holder 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 in relation to a VFA service can only be done by a licence holder and must be vetted and approved by its board of administration.

I. CONTROL OF ASSETS

A licence holder that controls assets belonging to a customer in the course of rendering a VFA Service shall hold such assets solely in the interest of the customer.

To this effect, such assets shall:

- Form a distinct patrimony and be separate from the assets belonging to the licence holder;
- Be still deemed to be owned by the customer, notwithstanding that they are registered in the name of the licence holder;
- Not be subject to the rights of creditors of the licence holder.

Upon receipt of clients' money, the licence holder shall promptly place such money with any of the following:

- Central bank;
- Credit institution duly licenced in EU;
- Bank authorized in a non-EU country;
- Qualifying money market fund (Collective investment undertaking duly authorized under EU directive), provided customers give their explicit consent for such placement.

A licence holder may deposit VFA held by it on behalf of its customers into an account opened with a third party provided that the third party holds a licence under the Malta VFA Law or any other equivalent authorization issued by a European or overseas authority.

The licence holder shall not use the VFA which it holds on behalf of the customer for another person or customer unless both the following are met:

- Customer has given his prior express consent and
- Use of customer's VFA is restricted to the specific term of consent.

J. FUNCTIONS AND DUTIES OF THE LICENCE HOLDER

The following are the salient functions and duties of the licence holder as detailed out in the regulations:

- Safeguard assets in the interest of customers;
- Maintain proper and adequate records and accounts of all customers' assets held under control. Such records are to clearly indicate that the assets of every customer are separate and distinct from assets belonging to the licence holder, and should indicate where any pledge or right over assets held by the licence holder has been given by customers to any third party;
- Conduct reconciliations between its records and accounts of third parties with whom customer's VFA has been deposited on a regular basis;
- Segregate in a proper manner all assets of every customer from assets belonging to the licence holder;
- Make all appropriate arrangements for protection of customers' assets;
- Take all steps to ensure that VFA deposited with a third party in accordance to the law are identifiable separately from the VFA belonging to that third party, via tilted accounts;
- Implement organizational arrangement to minimise risk of loss or diminution of assets.

A licence holder may delegate the above functions to another licenced person and may also entrust or deposit customer's assets to such person. However, the original licence holder shall remain fully liable notwithstanding such delegation.

K. CERTIFICATE OF COMPLIANCE

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

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

L. DUTIES UNDER ANTI-MONEY LAUNDERING LAWS

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

In essence, this implies that the licence holder 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.

M. 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.

N. EXEMPTIONS FROM REQUIREMENT OF LICENCE

The following persons are exempt by law from the requirement to obtain a licence for the provision of VFA services:

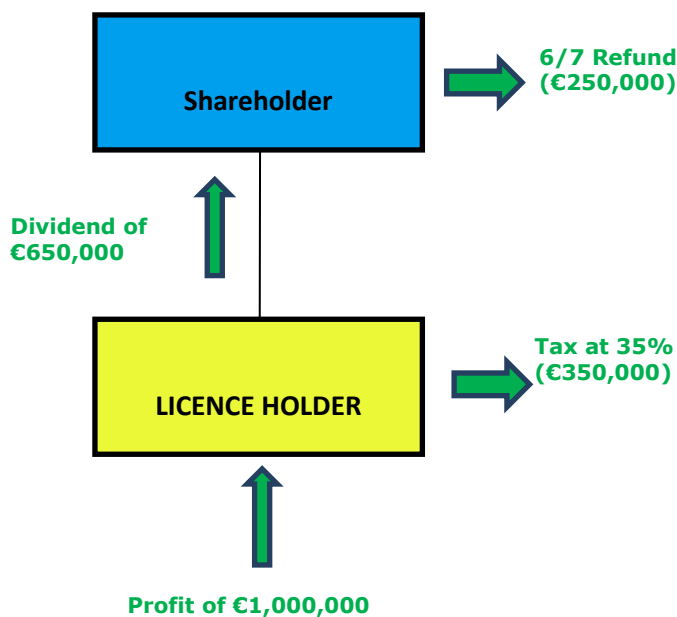
- Central Banks that are members of the European System of Central Banks;
- Liquidator or curator in bankruptcy acting in liquidation or bankruptcy;
- Persons dealing on own account and not providing any other VFA services unless such persons are (i) market makers or (ii) deal on own account when executing client orders;
- Persons providing VFA services exclusively for their own group companies;
- Persons licenced to act as custodians under Maltese Law in regards to a collective investment scheme – in such a case, the exemption shall solely be with regards to custodian services to VFA;
- Persons licenced to provide services of management of investment under Maltese Law – in such a case, the exemption shall solely be with regards to provision of Portfolio Management and Investment Advice services;
- Individual providing portfolio management of VFA for close family, or personal VFA, provided he is not remunerated and does not hold himself as providing VFA Services;
- Persons providing VFA Service where that service is provided in an incidental manner in the course of a legally regulated professional activity;
- Licenced Securitisation Special Purpose entities and Collective Investment Schemes.

O. TAXATION

1. 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%.

2. Taxation on transfers

Provided that there is no change in beneficial owner of the VFA, the following shall not be deemed to constitute a chargeable transfer for the purposes of the Maltese Income Tax and Stamp Duty legislation:

- delivery of a VFA of a customer to a licence holder;
- delivery of a VFA from a licence holder to a customer;
- delivery of a VFA from a licence holder to another licence holder.

3. Personal tax incentives for directors

Foreigners who seek to relocate to Malta and be employed or occupy certain positions in the Licence Holder, may apply for a special Scheme in order to be granted a special tax status. The employment income will be taxed at a flat 15% on all income derived in Malta up to a maximum of €5,000,000, following which the excess is not subject to tax.

Further information on this may be found specifically on our other publications.

P. TRANSITORY PROVISIONS

Any person who is conducting any regulated activity is required to comply with the new laws once they come into force. The law provides a stipulated time frame of **twelve months** for a person that is offering VFA Services to apply for a licence and regulate its position accordingly.

Q. CONCLUSION

The innovative Blockchain technology has affected all areas of business. Malta took the initiative to regulate not merely ICOs, but also any provision of services that relate to such Virtual Financial Assets, in order to offer a unique and pioneering legislation seeking to transform Malta into a Blockchain island.

R. ANNEX I – LICENSING FEES PAYABLE TO THE MFSA

The fees payable to the MFSA depend on the Class of licence and are payable as follows:

LICENCE	APPLICATION FEE	ANNUAL SUPERVISORY FEE*	
CLASS 1	€3,000	For revenue up to €50,000	€2,750
		Further tranches of €50,000 up to a maximum of €1,000,000	€350 per tranche or part thereof
CLASS 2	€5,000	For revenue up to €250,000	€4,500
		Further tranches of €250,000 up to a maximum of €5,000,000	€400 per tranche or part thereof
CLASS 3	€7,000	For revenue up to €250,000	€6,000
		Further tranches of €250,000 up to a maximum of €50,000,000	€400 per tranche or part thereof
CLASS 4	€12,000	For revenue up to €1,000,000	€25,000
		Further tranches of €1,000,000 up to a maximum of €100,000,000	€2,500 per tranche or part thereof

*Payable upon the anniversary of the date of the granting of registration.

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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