



BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

Proposed Amendments to the Digital Asset Business Act 2018 and the Digital
Asset Business (Prudential Standards) (Annual Return) Rules 2018

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The Digital Asset Business (DAB) sector and other interested persons are invited to share their views on the proposals in this paper and the proposed legislative amendments. Comments should be sent to the Bermuda Monetary Authority digitally via the survey link or QR code below no later than **9 December 2024**.

[\[https://www.surveymonkey.com/r/82SZHKM\]](https://www.surveymonkey.com/r/82SZHKM)



I. INTRODUCTION

1. In recent years, the local and international digital asset business (DAB) sector has experienced rapid growth and evolution, as is evident through the development of new and innovative solutions and business models. As such, Bermuda's regulatory and supervisory framework must keep pace with the dynamic nature of this market. In a continued effort to strengthen the legislative and regulatory framework for DABs and support responsible innovation, the Bermuda Monetary Authority (Authority or BMA) is proposing amendments to the Digital Asset Business Act 2018 (DABA or the Act) and the Digital Asset Business (Prudential Standards) (Annual Return) Rules 2018 (the Rules). The proposed updates aim to ensure that Bermuda's legislative and regulatory framework for digital assets remains pertinent and effective in this rapidly changing business environment.
2. The Authority has identified opportunities to strengthen the effective administration of DABA and its ancillary legislation by enhancing its rule-making powers, refining definitions and amending annual reporting requirements.
3. The proposed changes include the following:
 - a. Introduction of a definition of 'control of assets' to be applied throughout the Act;
 - b. Enhancement of powers to allow for rules related to liquidity requirements, capital requirements and wind-down planning;
 - c. Introduction of requirements related to wind-down planning;
 - d. Transition of specific 'civil penalties' to 'late fees' payable for non-compliance;
 - e. Amendment to the wording under section 18(4) of the Act to clarify the intents of said sub-section; and
 - f. Amendments to the Rules to update and clarify the items required in annual reporting.

The proposals above aim to clarify the legislation, enhance the Authority's administrative and enforcement powers and mitigate against non-compliance.

II. AMENDMENTS TO THE ACT

A. DEFINITION OF ‘CONTROL OF ASSETS’

4. In recent years, the Authority has observed the emergence of certain business models in the DAB sector which can broadly be classified into the following two categories: (i) businesses falling outside the ‘custodial wallet provider’ definition, which hold or control assets for their clients during their operations and (ii) businesses which, despite essentially offering custodial services, claim to be exempt from the above-cited definitional scope due to the terms of their contractual arrangements.
5. For both categories identified above, the fundamental obligation for asset protection persists, warranting the implementation of steadfast systems and the rigorous application of controls by DABs. Examples of such models include:
 - a. **The first category:** Stablecoin and token issuers which need to maintain sufficient backing assets in quantity and quality to be able to meet all redemption claims, payment service providers, as well as operators seeking to facilitate lending, borrowing and repurchase transactions in digital assets; and
 - b. **The second category:** Digital asset and digital asset derivative exchanges.
6. The Authority seeks to clarify the expectations of those licensees who hold and/or control client assets for both categories identified above by (i) introducing in section 2 of DABA a definition of ‘control of assets’ and (ii) expanding the scope of sections 17 and 18 of DABA to further encompass such business models. As it pertains to point (i) above, the Authority proposes to introduce the following definition:
 - a. ‘Control of Assets’ – Means holding or controlling assets belonging to, or on behalf of a client, by a licensed undertaking, acting in the course of providing a digital asset business activity, and includes custody of client digital assets in accordance with section 10(2)(d).
7. Licensed undertakings that control assets will, therefore, be required *inter alia* to segregate said assets (held on behalf of their clients) from their own assets and maintain enough assets to meet their client obligations. As pertains specifically to the second category of businesses identified above, claiming to be exempt from the ‘custodial wallet provider’ definition due to contractual arrangements, it is reiterated that the proposed amendments do not constitute new requirements for said operators but merely clarify the Authority’s expectations in relation to said licensees.

B. ENHANCEMENT OF RULE-MAKING POWERS

8. The Authority has identified certain rule-making powers that are necessary for the effective administration of the Act. The Authority notes that during the early development of the DAB regulatory framework, certain prudential standards were not envisaged for the market. However, as the market has grown and introduced new business models,

particularly those that interact with or operate like that of traditional financial markets, it has become necessary for additional prudential standards to be applied to the market. It should be emphasised that in the development of Rules, the Authority considers the principle of proportionality related to licensed undertakings and the activities in which they participate to ensure that requirements are appropriately applied.

9. It is proposed that section 7 of the Act be amended to provide the Authority with the power to make Rules in relation to:
 - a. Additional capital and solvency;
 - b. Wind-down plan;
 - c. Net assets; and
 - d. Liquidity.
10. Further to the previous section, and consequential to the introduction of the ‘control of assets’ definition, the Authority also proposes to amend section 7 of the Act by replacing the existing rule-making power for the ‘custody of client assets’ with the power to make Rules concerning the control of assets.

C. REQUIREMENT FOR A WIND-DOWN PLAN

11. The Authority expects that all DABs prepare and maintain a plan to facilitate the orderly exit from the market in the case of an adverse event, insolvency, crisis or a decision to cease operations. The supervisory objective of the wind-down plan is to ensure that adverse impacts on client interests and the digital asset market are minimised in the event of an exit from the market. The Act is, therefore, proposed to be amended to mandate that all licensed undertakings create and submit a wind-down plan to the Authority.

D. LATE FEES PAYABLE FOR NON-COMPLIANCE

12. The Authority proposes that certain civil penalties be replaced with late fees, specifically, those civil penalties currently applied to licensees who fail to file prudential and other returns or fail to provide a required notification to the Authority within a prescribed timeframe. In this regard, it is the Authority’s view that it would prove more proportionate and dissuasive for a late fee to be levied against licensees for such breaches instead of applying civil penalties.
13. To facilitate the above, it is proposed that amendments be made to the Act to remove certain references to civil penalties and replace them with late fees. It is proposed that a late fee be applied for the failure to submit regulatory filings, failure to make required notifications to the Authority and other specified regulatory reporting requirements within the timeframe prescribed in the Act. The proposed amount for the late fee is \$500 for Class M and T licensees and \$1,000 for Class F licensees, to be levied each week or part of a week that they are in default.

E. OTHER AMENDMENTS TO THE ACT

14. Further amendments proposed to be made to the Act are set out below:

a. Display and registration of licence

To ensure that clients and potential clients can easily communicate with licensed undertakings before doing business or continuing to do business with them, the following information will be published by the Authority:

- i. Address of the head office;
- ii. Address of the registered office;
- iii. Address of the principal place of business, in the case of a class T licensee; and
- iv. Business email address.

b. Amended wording under section 18(4) of the Act

In order to further clarify the intent behind section 18(4) of the Act, which is to ensure that assets falling within the scope of this section are never regarded or handled as part of a DAB's estate and consequently exposed to its creditors' claims, the Authority proposes to revise the verbiage used in the relevant sub-section.

c. Notifications of material change to business

The Authority receives a significant number of notification filings regarding material changes to the business, many of which are not necessarily considered material in nature.

To provide further clarity to the industry regarding this requirement, the below amendments to section 22 are proposed:

- i. An amendment to modify language to clarify what the Authority considers material changes related to new products. More specifically, under the proposed amendment, a notification requirement will be triggered only when a DAB wishes to offer a new product type (i.e., a category of products with different features and overall risk profile from those previously reviewed and approved by the Authority). For example, when a DAB already offers one single currency-pegged stablecoin (USDC or USDT) to its clients and wishes to onboard a new one, a material change in the business notification requirements will not be triggered under section 22 of the Act. This is because a new single currency-pegged stablecoin falls within the same 'product type'; and

- ii. An amendment to confirm the expectations for the notification of changes related to outsourced functions. Only where a DAB intends to outsource a critical function will a material change in business notification be required, pursuant to section 22 of the Act. The term ‘critical function’ should be understood as encompassing any operational function considered critical or important, where a flaw or failure in its performance would significantly affect a DAB’s ability to comply with the Authority’s legislative and regulatory requirements. Such a defect could also have a material impact on its operations and activities’ financial performance and stability or continuity.

However, DABs must forthwith notify the Authority immediately upon offering a new product or outsourcing a non-critical function.

In addition to the above proposed changes, the Authority anticipates updating the *Product Due Diligence Guidance Note* to provide additional clarity regarding material change notifications related to changes in product offerings.

d. Revocation of licence

The Authority aims to clarify that the expiration of a sandbox license (Class M or T) is distinct from the revocation of a license. More specifically, when a sandbox license reaches its stipulated expiration date, its validity automatically ceases without the need for any additional steps or procedures. This is inherently different from a license revocation, which is an active process involving specific procedural steps to officially withdraw the license. An amendment to section 24 of the Act is therefore proposed by deleting section 24(f).

It should be noted that the proposed changes to section 24 expand the list of criteria the Authority uses to revoke a license.

e. Winding up on petition of the Authority

To enhance the Authority’s enforcement power regarding the winding up of a licensed undertaking (on a petition presented to the Court), an amendment to section 25 of the Act is proposed by extending this power to the Authority in circumstances where the licensed undertaking is or has been operating in contravention of any provision of the Act.

f. Communication with the Authority

Amendments are proposed to address communication with the Authority by appointed persons. This new section will specify that no duty to which a person appointed to make a report to the Authority will be regarded as contravened by reason of their communicating in good faith on any matter relevant to the Authority’s functions.

g. Control of advertisements

Additionally, amendments are proposed to address conduct related to advertisements. DABs will be expressly prohibited from publishing any advertisement that is misleading as it relates to the licensee's assets, financial standing or any other material information. The intent is to ensure that DABs communicate with clients and potential clients in a fair, clear and non-misleading manner, as is consistent with international standards and the expectations of the Authority as it relates to the conduct of business.

h. Minimum licensing criteria

In accordance with the proposed amendments to enhance the Authority's rule-making powers, Schedule 1 of the Act should be amended in paragraph two to include an expressed requirement for licensees to maintain minimum net assets, capital and liquidity in accordance with the prudent operation of the business.

F. CONSEQUENTIAL AMENDMENTS

14. Consequential amendments will be made to the Fourth Schedule to the Bermuda Monetary Authority Act 1969 under the heading "Digital Asset Business Act 2018" to introduce a paragraph referencing the late fees alongside the amount levied. As noted, the fees are proposed to be \$500 for Class M and T licensees and \$1,000 for Class F licensees for each week or part of a week in which they are in default.

G. TRANSITIONAL

15. The Authority recognises that licensed undertakings will need an adjustment or transitional period to adequately meet the newly imposed requirements for controlling assets and formulating a wind-down strategy. Therefore, it is proposed that licensed undertakings will be afforded a timeline of twelve months to align their operations with these stipulated requirements.

III. AMENDMENTS TO THE RULES

16. Since 2018, the Authority has garnered much experience and a deeper understanding of the market's various business models, digital asset products, and operational structures. As a result, it has recognised the need to update the current prudential annual return requirements and reporting filings to ensure that the information collected is appropriate

and relevant to market developments. Another objective is to support effective monitoring and supervision of the DAB sector to strengthen Bermuda's regulatory framework.

17. The Authority has revamped the annual return and proposes amending the first Schedule to the Rules to reflect the updates. Such amendments are intended to provide clarity regarding prudential reporting expectations.

IV. CONCLUSION

18. The Authority remains committed to supporting responsible innovation while ensuring that legislation in the digital asset business market continues to be fit for purpose. As a financial services sector regulator, the Authority's objectives are to protect customers and maintain market confidence. The proposed amendments aim to effectively communicate the expectations regarding prudent operational measures while ensuring the Authority has sufficient administrative and enforcement powers to enhance the DAB regulatory framework.
19. The digital asset industry, including market participants, stakeholders, consumers, and other interested parties, is invited to use the link provided to submit feedback on the proposals in this paper by **6 December 2024**.