ISLE OF MAN
FINANCIAL SERVICES AUTHORITY
Lught-Reill Shirveishyn Argidoil Ellan Vannin

Questions & Answers for consumers in relation to Convertible Virtual Currency (including via an Initial Coin Offering)

This frequently asked questions ("FAQ") document aims to provide some advice for consumers who may wish to use cryptocurrency, it covers terminology and concepts, relevant legislation in this area and also the role of the Isle of Man Financial Services Authority ("the IOMFSA") in relation to this sector.

Please read in conjunction with the "Consumer Matters" brochure, and the AML/CFT Sector Guidance for virtual currency business published by the IOMFSA.

1. What is "cryptocurrency"?

Cryptocurrency can go by many different names such as: cryptocurrency; crypto assets; digital currency; tokens; or coins[1]. The particular area this guidance document focuses on is "**convertible virtual currency**" referred to as "**CVC**".

A CVC is a digital method of financial exchange. This means of exchange of value may be used to overcome any potential perceived limitations of existing currencies and/or financial systems. Users of a CVC typically set up an electronic wallet in which to hold their CVC, this allows them to accept transfers and withdraw the CVC as required.

Traditional CVC is underpinned by the "blockchain" technology, an electronic ledger which records all of the transactions undertaken through it. The blockchain shares and updates all of the transactions on this ledger across many computers. This decentralised nature, or "distributed ledger", is what gives the blockchain its strength because no single entity has the ability to control or manipulate the contents on the blockchain.

Please note this does not mean that cryptocurrencies are without significant risk. Further details of some of the risks and "red flags" in relation to the use of cryptocurrencies can be found in the AML/CFT Sector Guidance for virtual currency businesses.

[1] it should be noted that the terms "token" and "coin" are often used interchangeably, however please note the different meanings set out in the glossary.

2. Glossary of terms

This glossary sets out some of the common terms used when describing concepts relevant to this sector.

AML/CFT means Anti Money Laundering and Countering the Financing of Terrorism;

Coin refers to a unit, or means of exchange and therefore has an ascribed / notional value. It is a means of transfer of that value between two parties, a store of value and a unit of account. Goods and services may be priced in the coin. One of the most well-known crypto coins is Bitcoin: it can be used to pay for goods or services, it can be stored for a period of time and then used, and you can sometimes see things priced in Bitcoin; please also see the definition of token, these terms are often used interchangeably;

CVC / Convertible virtual currency[2] may be converted into a fiat currency, either directly, or through an exchange. For a CVC to be convertible, there does not need to be set value or rate, nor an established benchmark, merely that the ownership rights can be transferred from one person to another, whether or not they are exchanged for money, another token or something else entirely;

DBRO means the Designated Businesses (Registration & Oversight) Act 2015;

Digital currency refers to any electronic representation of a fiat currency and can include representations of convertible virtual currency and electronic money;

Distributed ledger or Distributed ledger technology ("DLT") is a digital system which records cryptocurrency transactions in multiple places at the same time. Distributed ledgers have no central data store or administration function. DLT's such as the blockchain are made up of a number of nodes that process and verifies the transactions. In creating a record of these transactions a cryptocurrency or even part of the cryptocurrency's past transactions can be traced back the blockchain;

Fiat currency also known as "real currency", "real money" or "national currency" and includes the coin and paper money issued by a country that is designated as legal tender;

Initial Coin Offering ("ICO") is similar to a company raising finance by an initial public offering, but traditional company law safeguards do not apply. ICOs (or the funds raised from them) may be used by start-up businesses to develop services and products. Therefore, ICOs usually involve people paying for the "coin / token", but they can also be given away;

Token usually offers the holder functionality rather than any form of value in digital cash. Tokens are often created to encourage user interaction and perhaps to provide non cash rewards to the network's participants. A token may provide access to voting systems, or to access pre-released media or they may be used as digital reward scheme tokens, similar to

[2] Please see question 7 of this document for the Isle of Man specific definition of this term.

the stamp on a beverage loyalty card; please also see the definition of coin, these terms are often used interchangeably; and

Wallet refers to an electronic file, often held on a smartphone, used to hold electronic funds which allows a user to accept transfers and withdraw funds of CVC.

3. What are the different types of CVC business?

By way of a breakdown of activity in the Isle of Man, the three key types of registered CVCs typically undertake the following types of activity:

- **Administering, managing, lending, buying, selling, exchanging or otherwise trading** – allowing customers to exchange fiat currency for CVC and vice versa as well as trading between different CVCs.
- **Issuing, transmitting and transferring ("ICO") –** the issuance of a token or coin, often to raise funds for a particular product or software/service (typically blockchain). The coin purchased at the time of the ICO usually brings with it a benefit to the purchaser once the ICO is complete, also the coin may be discounted at various times throughout the ICO (bigger discount early and for higher amounts purchased). However, sometimes a token or coin may not be purchased (see question 5).
- **Providing safe custody or storage of CVCs -** customers can store or hold their coins or tokens to pay for goods or services, typically referred to as a "wallet".

4. What is an "airdrop"?

Not all cryptocurrency is purchased, some can be given away or "mined". This can vary depending on the CVC being offered and the business model of the entity involved. An "airdrop" refers to the distribution of CVC usually for free. The airdrop may be used to attract potential new users of the CVC or to generate attention, for example showcasing the blockchain technology an entity has developed.

5. What are the implications if a coin or token is issued for free?

A token usually has no formal value attributed to it and is not exchangeable for a fiat currency (similar to the points on a loyalty card). Where there is no set value associated with a token, users of the token may agree to set their own value to trade between each other. Alternatively, the ownership rights of the token could be transferred for no consideration.

Where a token or coin has no attributed value, as it is not exchangeable for a recognised currency, it would not usually be able to be used to transact with retailers to buy goods etc. Of course, any person or retailer may choose what they will accept as payment, whether that is real money, tokens, bartered services in lieu or other non-fiat items such as buttons.

Where there is a free offering of a token, the IOMFSA will only register a business issuing free tokens on the condition that the business must not accept any payment or customer funds in relation to these tokens, in order to limit the money laundering and terrorist financing risk

Question 11 explains how to check the IOMFSA register and view any conditions that have been attached to a registration.

6. In what circumstances should I provide my personal data?

When signing up for a wallet, and to use cryptocurrency, you will be asked for relevant personal details in order for the issuer to conduct the necessary customer due diligence in order to comply with their obligations under the Anti-Money Laundering and Countering the Financing of Terrorism Code 2019 ("the AML/CFT Code").

If this circumstance arises it is prudent to check the entity is registered with the IOMFSA as a designated business, also that the entity is registered with the Information Commissioner as a data processer and/or controller. You have certain rights in relation to other parties using your data, further information is available from the Information Commissioner's Office here.

7. Where does the business of issuing Convertible Virtual Currency ("CVC") (such as via an Initial Coin Offering "ICO") fit in Isle of Man legislation?

Schedule 4 to the Proceeds of Crime Act 2008 ("POCA") sets out those businesses in the Isle of Man which are considered to be "Business in the Regulated Sector" and therefore subject to the requirements of the AML/CFT Code.

In 2015 the Schedule was amended[3] to include convertible virtual currency which is defined as:

> ***issuing****, transmitting, transferring, providing safe custody or storage of, administering, managing, lending, buying, selling, exchanging or otherwise trading or intermediating* ***convertible virtual currencies, including crypto-currencies or similar concepts where the concept is accepted by persons as a means of payment for goods or services, a unit of account, a store of value or a commodity*** *(emphasis added)*

Therefore, issuing CVC (which could be via an ICO or similar concept), in or from the Island falls under the above definition and is classed as "Business in the Regulated Sector". This means it is subject to the requirements of the AML/CFT Code, and would also have other obligations placed on it which are covered below in more detail.

[3] Proceeds of Crime (Business in the Regulated Sector) Order 2015

8. What does this mean for businesses that fall within the "Business in the Regulated Sector" list under Schedule 4 to the Proceeds of Crime Act 2008?

"Business in the Regulated Sector" for the purposes of the Proceeds of Crime Act 2008 means that legislation in relation to the prevention of financial crime applies to those businesses (for example the AML/CFT Code).

Many of the business sectors in Schedule 4 to POCA are fully regulated by the IOMFSA, for example, under the Financial Services Act 2008 or the Insurance Act 2008. These businesses are subject to a wide array of regulatory controls and detailed scrutiny as required by the terms of the legislation they are regulated under.

Designated businesses, including CVCs, are registerable with the IOMFSA under the Designated Businesses (Registration and Oversight) Act 2015 ("DBRO")[4]. This means there is a registration requirement for these businesses and the IOMFSA has the power to oversee these businesses only in respect of AML/CFT compliance.

Oversight of registered entities does not extend to areas that would be considered in relation to a regulated entity such as conduct of business, corporate governance, solvency or client money regulation /protection of client assets.

Please note that a registration of a designated business is not a tacit approval of the business and its activities. The IOMFSA's remit only focuses on designated businesses' compliance with the AML/CFT Code.

The public engages with any crypto currency at its own risk and should, as with any financial decision, take reasonable measures to understand the business/activity and to receive the appropriate advice.

9. What is the role of the Isle of Man Financial Services Authority in relation to CVCs?

The IOMFSA registers, and oversees, any businesses that are included within the remit of the DBRO. There is a process to be completed in order to become registered as a designated business. The IOMFSA has published a registration policy which outlines what it expects of an applicant in terms of fitness and propriety.

In summary the IOMFSA in assessing fitness and propriety considers:

- the applicant's integrity;

[4] Schedule 1 to the DBRO sets out those business activities from Schedule 4 of POCA that are classed as designated businesses.

- the integrity of the applicant's controllers (such as shareholders) and directors;
- the integrity and competence of the Money Laundering Reporting Officer ("MLRO") and, where appointed, the Deputy MLRO and Compliance Officer[5]; and
- the nature and scale of the designated business the applicant proposes to carry on.

The IOMFSA has powers under the DBRO to oversee compliance with financial crime legislation (which includes the AML/CFT Code). It would usually do this by way of an onsite inspection and/or periodic returns. The DBRO includes powers to inspect the accounts, books and records of the business and take copies of those records.

10. What obligations are placed upon CVCs?

The DBRO imposes a number of obligations on the CVC business. Some of those requirements include that it must keep all of the information submitted as part of its application for registration accurate and up to date, file an annual return and provide information or documentation to the IOMFSA upon request.

The AML/CFT obligations imposed on the business are detailed in the AML/CFT Code, and include requiring businesses to:

- identify and take reasonable steps to verify the identity of their customers including the beneficial owners of the customers and any persons who are empowered to act on their customers' behalf;
- assess the money laundering / financing of terrorism risks facing it, as well as the risks posed by its customers;
- monitor the transactions and activity of the customers on an ongoing basis;
- keep records of all customers and transactions;
- have appropriate procedures in place to report a suspicion.

In order for the IOMFSA to be able to successfully undertake its statutory duty of overseeing the compliance of designated businesses with the AML/CFT Code, designated businesses must have sufficient real presence to facilitate oversight.

Given the nature of CVC business, and in order to ensure oversight can effectively take place, the IOMFSA will not register a CVC business unless the following two conditions of registration are met:

a) the CVC business must have (and continue to have) at least 2 IoM resident directors; and;
b) management and control of the CVC business must be in the Island.

[5] A competence assessment of the MLRO, Deputy MLRO and Compliance Officer relates to their competence in AML/CFT matters only.

Because of the limitation of the IOMFSA's ability to oversee CVC businesses which lack substance or real presence on the Island this is considered to pose an unacceptably high risk of Money Laundering or Financing Terrorism.

11. How do I know if a CVC business is registered with the IOMFSA?

A public register is available on the IOMFSA's website which includes details of all registered persons, including whether any conditions have been placed on their registration.

The IOMFSA may apply conditions to designated businesses which register with the IOMFSA in order retain the risk profile of any activities relating to a registered person in line with the designated business registration policy.

If you think someone is seeking to offer designated business services without a suitable registration, or outside the terms of a condition which has been placed on their registration, please contact us at info@iomfsa.im.