

# The VFA Act: Rules and Regulations

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## Role of VFA Agent

- Role defined in Article 7 of the VFA Act and further explained in VFA Rules
- Initial and Ongoing role for Issuers of VFAs
- Initial Role for VFA Service Providers mainly during authorisation phase

## Role of VFA Agent

- Viewed as an extension to MFSA.
- Expected to carry out extensive due diligence on Issuers and VFA Service Providers.
- Liaison between MFSA and Issuer/ VFA Service Provider.

# Rules: VFA Agents

- Chapter 1 divided into 4 titles:
  1. **Principles:** The high level principles which should guide VFA Agents in the provision of their services;
  2. **Registration:** The Registration requirements and the respective registration process for VFA Service Providers;

# Rules: VFA Agents

- Chapter 1 divided into 4 titles:
  3. **Ongoing Requirements:** The ongoing obligations which VFA Agents must adhere to; and
  4. **Enforcement:** Enforcement and sanctions in the event of misconduct by VFA Agents.

# Rules: VFA Agents

## High Level Principles

- VFA Agents shall act in an ethical manner taking into consideration the best interests of their clients and the integrity of Malta's financial system.
- VFA Service Providers shall act honestly, fairly and professionally and shall comply with the relevant provisions of the VFA Act, the regulations issued thereunder, and the MFSA Rules as well as with other relevant legal and regulatory requirements.

# Rules: VFA Agents

## High Level Principles

- VFA Agents shall co-operate with the MFSA in an open and honest manner and shall provide the Authority with any information it may require.
- VFA Agents shall take due account and, where applicable, comply with any relevant EU legislation as well as any Guidance Notes/ Statements/ Industry Best Practices which may be issued by international standard setting bodies.

# Rules: VFA Agents

## Registration

- Considerations of MFSA:
  1. the protection of investors and the general public;
  2. the protection of the reputation of Malta taking into account Malta's international commitments;
  3. the promotion of innovation, competition and choice; and
  4. the reputation and suitability of the Applicant and all other parties connected with the Applicant.

# Rules: VFA Agents

## Registration

- Different types of registration Article 7 only, Article 14 only or Article 7 and 14
- An Applicant shall propose at least three persons who shall be responsible for performing the activity of a VFA Agent – The Designated Persons
- MLRO must be a Designated Person (where necessary)

# Rules: VFA Agents

## Registration

- Fit and Proper – Integrity, Competence and Solvency of qualifying shareholders, directors and senior managers including Designated Persons
- Capital Requirements:
  - Article 7: EUR75K + PII or EUR150K
  - Article 14: EUR75K + PII (best efforts)
  - Article 7 and 14: EUR75K + PII or EUR150K

# Rules: VFA Agents

## Registration

- Statement of intent and preliminary meeting:
- Applicant to submit:
  1. a comprehensive written description of the proposed structure;
  2. Type of registration requested.

# Rules: VFA Agents

## Registration

- Application to be filed within 60 days from date of preliminary meeting (where held)
- Pre Registration phase vs, post registration phase – pre commencement of business,
- Outline of process for (A) change in control, (B) revision of registration, (C) suspension of registration and (D) cessation of business of a VFA Agent
- Matters requiring notification to or prior approval of MFSA

# Rules: VFA Agents

## Ongoing Requirements

- Governance – Business to be directed by at least 2 individuals
- Establishment of various policies and procedures (decision making, internal controls, internal reporting, communication of information, record keeping, security measures, remuneration policy, personal transactions, risk management framework, due diligence systems, business continuity plan, disaster recovery plan)

# Rules: VFA Agents

## Ongoing Requirements

- Establishment of a Compliance and AML functions
- Submission of Annual Compliance Certificate to MFSA
- Need for PII Cover (Rel Incx3 or EUR1M/ Rel Incx3 or EUR1.5M)
- Framework for outsourcing and related oversight
- Record Keeping 5 years, possibly 7
- Due Diligence Requirements on prospective clients

# Rules: VFA Agents

## Ongoing Requirements

- Additional requirements in respect of VFA Agents appointed by Issuers of VFAs
- Fit and proper assessment on Issuer and its Directors
- Monitor of development of business undertaken by issuer
- Compliance Certificate drawn up by Issuer



# Rules: VFA Agents

## Enforcement

- Extensive powers of enforcement by MFSA
- Sets out basis for enforcement actions including fines

# Rules: VFA Service Providers

- Chapter 3 divided into 4 titles:
  1. **Principles:** The high level principles which should guide VFA Service Providers in the provision of their VFA activity
  2. **Authorisation:** The licensing requirements and the respective licensing process for VFA Service Providers;

# Rules: VFA Service Providers

- Chapter 3 divided into 4 titles:
  3. **Ongoing Requirements:** The ongoing obligations which VFA Service Providers must adhere to; and
  4. **Enforcement:** Enforcement and sanctions in the event of misconduct by VFA Service Providers.

# Rules: VFA Service Providers

## High Level Principles

- VFA Service Providers shall act in an ethical manner and in the best interest of Malta, taking into consideration investor protection, market integrity and financial soundness in carrying out their activity.
- VFA Service Providers shall act honestly, fairly and professionally and shall comply with the relevant provisions of the VFA Act, the regulations issued thereunder, and the MFSA Rules as well as with other relevant legal and regulatory requirements.

# Rules: VFA Service Providers

## High Level Principles

- VFA Service Providers shall co-operate with the MFSA in an open and honest manner and shall provide the Authority with any information it may require.
- VFA Service Providers shall take due account and, where applicable, comply with any relevant EU legislation as well as any Guidance Notes/ Statements/ Industry Best Practices which may be issued by international standard setting bodies.

# Rules: VFA Service Providers

## Authorisation

- Licensing Considerations of MFSA:
  1. the protection of investors and the general public;
  2. the protection of the reputation of Malta taking into account Malta's international commitments;
  3. the promotion of innovation, competition and choice; and
  4. the reputation and suitability of the Applicant and all other parties connected with the Applicant.

# Rules: VFA Service Providers

## Authorisation

- Different Classes of licences as per VFA Regulations
- Role of the VFA Agent
- Role of Systems Auditor (where necessary)
- Fit and Proper – Integrity, Competence and Solvency of qualifying shareholders, directors and senior managers
- Capital Requirements

# Rules: VFA Service Providers

## Authorisation

- Statement of intent and preliminary meeting:
- Applicant to submit through VFA Agent:
  1. a comprehensive written description of the proposed structure;
  2. the VFA Service/s for which Licensing is being sought identifying the persons proposed to hold key positions thereto;
  3. a legal opinion that the proposed activity does not fall within the scope of traditional financial services

# Rules: VFA Service Providers

## Authorisation

- Application to be filed within 60 days from date of preliminary meeting
- Pre licensing phase vs, post licence phase – pre commencement of business,
- Outline of process for (A) change in control, (B) variation of licence, (C) suspension of licence and (D) surrender of licence
- Matters requiring notification to or prior approval of MFSA

# Rules: VFA Service Providers

## Ongoing Requirements

- Governance – Business to be directed by at least 2 individuals
- Establishment of various policies and procedures (decision making, internal controls, internal reporting, communication of information, record keeping, security measures, remuneration policy, conflicts policy, risk management framework, business continuity plan, disaster recovery plan, inducements, personal transactions, order execution policy)



# Rules: VFA Service Providers

## Ongoing Requirements

- Establishment of a Compliance and AML functions
- Submission of Annual Compliance Certificate to MFSA
- Rules for Segregation of Clients Assets
- Monthly reconciliations of VFAs held under custody & Clients' Money (FIAT)
- Establishment of Internal Audit Function (not mandatory)
- Need for PII Cover



# Rules: VFA Service Providers

## Ongoing Requirements

- Framework for outsourcing and related oversight
- Additional Rules for VFA Exchanges in particular on the listing criteria
- Capital requirements and own funds including fixed overhead requirements and RMICAAP
- Distinction between Retail and Professional Clients

# Rules: VFA Service Providers

## Ongoing Requirements

- Independent vs Non Independent Advice
- Appropriateness and Suitability Assessment
- Issue of Suitability Statement
- Complaints Handling Process
- Record Keeping 5 years, possibly 7
- Audited Accounts within 4 months from Y/E.

# Rules: VFA Service Providers

## Ongoing Requirements

- Quarterly Interim and Annual Financial Return within 1 month
- Disclosure of (a) risk management framework, (b) governance, (c) own funds and (d) capital requirements

# Rules: VFA Service Providers

## Enforcement

- Extensive powers of enforcement by MFSA
- Sets out basis for enforcement actions including fines

# The Financial Instrument Test

- The VFA Act provides that a “DLT asset” is:
  - i. a virtual token;
  - ii. a virtual financial asset;
  - iii. electronic money; or
  - iv. a financial instrument,that is intrinsically dependent on, or utilises DLT.



# The Financial Instrument Test

- Unlike what the name implies the Financial Instrument Test is used for the purposes of the classification a DLT Asset as a: (A) a virtual token; (B) virtual financial asset; (C) electronic money; or (D) a financial instrument.
- The FI Test is essentially an excel file and a guidance note issued by the MFSA.

# The FI Test – E Money

- The VFA Act, refers to the Financial Institutions Act for the definition of electronic money
- We need to determine whether the DLT Asset qualifies as electronic money

## The FI Test – E Money

- "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 .... and which is accepted by a natural or legal person other than the financial institutions that issued the electronic money

## The FI Test – E Money

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT issued by the issuer on receipt of funds at par value, and redeemable at par value with the issuer upon request of the holder? **[YES]**

## The FI Test – E Money

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the holder of the DLT Asset have a claim against the issuer's assets arising from the funds originally placed against the issuance of such DLT assets? **[YES]**

## The FI Test – E Money

- MFSA Guidance Note looks at the following attributes:
  - iii. Is the DLT Asset used for the purpose of a payment transaction, which may be initiated by the payer or by the payee, of placing, transferring or withdrawing funds, irrespective of any underlying obligations between the payer and the payee? **[YES]**

## The FI Test – E Money

- For a DLT asset to qualify as Electronic Money, (a) the DLT asset should not fall within the exemption specified in Article 3(k) of Directive (EU) 2015/2366 and (b) the payment transaction should not fall within the exemption specified in Article 3(k) of the said Directive - Limited Network Exemption.

## The FI Test – Virtual Token

- “virtual token” means a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform on or in relation to which it was issued or within a limited network of DLT platforms:

# The FI Test – Virtual Token

Provided that the term "DLT platform" referred to in this definition shall exclude DLT exchanges.

Provided further that a virtual token which is or may be converted into another DLT asset type shall be treated as the DLT asset type into which it is or may be converted.

# The FI Test – Virtual Token

- MFSA Guidance Note looks at the following attributes:
  - i. Does the Token Standard allow the DLT asset's conversion into another DLT asset type? Token Standard is a technical specification that defines a common list of rules applying to every DLT asset on a particular DLT network and by which every DLT asset interacts with others on the said network **[NO]**

# The FI Test – Virtual Token

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the Token Standard support Atomic Swapping or any other type of interoperability outside (i) the DLT platform on or in relation to which it was issued or (ii) a limited network of DLT platforms? **[NO]**

# The FI Test – Virtual Token

- MFSA Guidance Note looks at the following attributes:
  - iii. Does the issuer intend to list or admit a DLT asset to trading on an exchange, either locally or abroad? **[NO]**
  - iv. Is the DLT Asset a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services? **[YES]**

# The FI Test – Fin. Instrument

- “financial instrument” shall have the same meaning assigned to it under the Second Schedule to the Investment Services Act, whether or not issued in Malta
- Covers: (A) Transferable Securities, (B) Money Market Instruments, (C) Collective Investment Schemes, (D) Financial Derivative Instruments and (E) Emissions Allowances.

# The FI Test – Fin. Instr. (TS)

## A. Transferable Securities

- Focus on (A) Maturity, (B) Features of the DLT Asset, (C) Exchangeability and (D) whether it classifies as an instrument of payment.

## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - i. Does the DLT Asset have a maturity at issuance greater than 397 days? **[YES]**;

## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Is DLT asset used to initiate / conclude a transaction to buy goods/ services as agreed between two or more parties and accordingly functions as a means of payment/ medium of exchange i.e. acts as an instrument of payment? **[NO]**



## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is DLT Asset negotiable or capable of being traded on the capital market? **[YES]**

## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features **[YES]**:
    1. Right to participate in the capital of the issuer
    2. Right to receive proceeds from the liquidation of issuer in excess of nominal value

## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features [YES]:
    3. Entry in the register of shareholders
    4. Right to a principal amount due of fixed sum with fixed/ variable maturity

## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features [YES]:
    5. Entry in the register of debenture holders
    6. Right to acquire or sell a transferable security

## The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features [YES]:
    7. Right to an amount settled in cash determined by reference to transferable securities, currencies [FIAT], interest rates or yields, commodities or other indices or measures

## The FI Test – Fin. Instr. (MMI)

### B. Money Market Instrument

- Focus on (A) Maturity, (B) Features of the DLT Asset, (C) Exchangeability and (D) whether it classifies as an instrument of payment.

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - i. Does the DLT Asset have a maturity at issuance less than 397 days? **[YES]**;

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - ii. Is DLT asset used to initiate / conclude a transaction to buy goods/ services as agreed between two or more parties and accordingly functions as a means of payment/ medium of exchange i.e. acts as an instrument of payment? **[NO]**

## The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is DLT Asset negotiable or capable of being traded on the capital market? **[YES]**

## The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT asset qualify as a derivative **[NO]**
  - v. Can the value of the DLT Asset be accurately determined at any point in time **[YES]**

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - vi. Does the DLT Asset exhibit any of the following features [YES]:
    1. The DLT asset gives rise to an on or off-balance sheet obligation towards the issuer;
    2. Entry in the register of debenture holders

# The FI Test – Fin. Instr. (CIS)

## C. Collective Investment Schemes

- Focus on (A) Purpose and (B) Arrangement/Structure.
- Structures that pursue a commercial or industrial activity should not be deemed to be undertaking “collective investment of capital”

## The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - i. Does the DLT Asset qualify as (A) a unit in a scheme or arrangement which has as its object or as one of its objects the collective investment of capital and (B) where the capital is raised through offer of DLT assets for subscription, sale or exchange from one or more investor **[YES]**

## The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT Asset exhibit any of the following features **[YES]**:
    1. The contributions of the participants and the profits or income out of which payments are to be made to them are pooled;

## The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT Asset exhibit any of the following features [YES]:
    2. Units are or are to be repurchased or redeemed out of the assets of the scheme or arrangement, continuously or in blocks at short intervals at the request of the holders;

## The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT Asset exhibit any of the following features [YES]:
    3. Units are, or have been, or will be issued continuously or in blocks at short intervals



# The FI Test – Fin. Instr. (FDIs)

## D. Financial Derivative Instruments

- Focus on (A) Contract Type, (B) Underlying and (C) Settlement terms and in some instances (D) Purpose.
- Main categories: options, futures, forwards, swaps and CFDs.

# The FI Test – Fin. Instr. (FDIs)

- FDI test is based on the list of financial instruments under MIFID
- 7 different categories of FDIs – Paras C(4) to C(10) of Section C of Annex 1 to MIFID II

# The FI Test – Fin. Instr. (FDIs)

## Para C(4):

- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;

# The FI Test – Fin. Instr. (FDIs)

## Para C(5):

- Options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event.

# The FI Test – Fin. Instr. (FDIs)

## Para C(6) :

- Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled.

# The FI Test – Fin. Instr. (FDIs)

## Para C(7) :

- Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in point 6 of this Section and not being for commercial purposes, which have the characteristics of other derivative financial instruments;

# The FI Test – Fin. Instr. (FDIs)

## Para C(8):

- Derivative instruments for the transfer of credit risk

# The FI Test – Fin. Instr. (FDIs)

## Para C(9):

- Financial contracts for differences.

# The FI Test – Fin. Instr. (FDIs)

## Para C(10):

- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event,...

# The FI Test – Fin. Instr. (FDIs)

## Para C(10):

- ...as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF

# The FI Test – Emissions Allow.

## E. Emissions Allowances

- Focus on (A) Issuer, (B) Manner in which it is issued

# The FI Test – Emissions Allow.

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT Asset issued by the national competent authority in terms of Directive 2003/87/EC for the purposes of Directive 2003/87/EC [YES].



**Thank you**

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