



ISLE OF MAN  
FINANCIAL SERVICES AUTHORITY

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REQUEST FOR INPUT RESPONSE

FS22-01

**REQUEST FOR INPUT  
INNOVATION AND THE REGULATORY  
PERIMETER**

Issue Date: 02 November 2022

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## GLOSSARY

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<b>Term</b>	<b>Meaning in this document</b>
<b>AML/CFT</b>	Anti-money laundering / Countering the financing of terrorism
<b>Authority</b>	Isle of Man Financial Services Authority
<b>Crypto-assets / CVC</b>	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
<b>FSA08</b>	Financial Services Act 2008
<b>IA08</b>	Insurance Act 2008
<b>IT</b>	Information technology
<b>NFT</b>	Non-Fungible Token
<b>RBSA00</b>	Retirement Benefits Schemes Act 2000
<b>Regulated entity</b>	<p>This term is used to mean any of the following:</p> <ul style="list-style-type: none"><li>• a licenceholder under the FSA08;</li><li>• persons authorised or registered under the IA08;</li><li>• permit holders, other than EU permit holders, under the IA08;</li><li>• persons registered under the RBSA00;</li><li>• corporate trustees of authorised retirement benefits schemes; or</li><li>• the governing bodies of certain collective investment schemes</li></ul>

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## **1 BACKGROUND**

This Response to the Request for Input is issued by the Isle of Man Financial Services Authority ('the Authority') following the Request for Input DP22-01, which was open from 21 February 2022 to 18 April 2022.

The purpose of the Request for Input was to seek information and opinion on the implications of innovation in connection with certain activities which are currently not regulated.

This Response Document will be most relevant to Government Departments, Statutory Boards and all businesses and individuals with a nexus to the Isle of Man.

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## 2 SUMMARY OF RESPONSES

The Authority received 9 responses to its Request for Input which came from:

- 4 regulated entities;
- 2 start-up businesses not established or trading;
- 1 licensed gaming business;
- 1 registered designated business (a crypto-asset exchange); and
- 1 member of the public.

In summary, all respondents generally agreed that some crypto-asset businesses should be regulated. Each respondent draws the line of that potential regulatory perimeter in a different place, although in general there was some consensus that crypto-asset exchanges should be subject to some form of regulation.

Although most respondents believe that elements of the sector should be regulated, either in whole or in part, there were mixed feelings regarding whether this would be a net benefit to the economy. Comments were that any regulation should be “proportionate”, and the framework should be purpose built rather than simply “slotted in” to an existing regulatory framework. On the whole it was felt that regulation would add credibility to the sector and so make it more attractive, but that “over-regulation” would cause the industry to fail and any regulation must not “stifle” the business’ growth.

### 3 SPECIFIC ENQUIRIES RAISED AND THE AUTHORITY'S RESPONSE

The questions asked by the Authority along with a summary of the responses received and the Authority's response are shown in the following table:

Question 1	
<p>If you are a crypto-asset business already on the Isle of Man – what was it about the Island that attracted you to establish here?</p>	
Responses received (in summary)	Authority's response
<p>Most respondents who are already established on the Island as crypto-asset service providers were already resident on the Island before establishing the business.</p>	<p>This illustrates that the Island's established crypto-asset service providers are developing domestically, rather than migrating into the Island.</p>
Question 2	
<p>If you consider that regulation is needed in some areas, please let us know if you believe that a financial services regulator is the appropriate body, or if you have any other views as to the type of entity that should undertake such regulation.</p>	
Responses received (in summary)	Authority's response
<p>All respondents generally agree that some crypto-asset businesses should be regulated although each respondent draws the line in a different place.</p> <p>Most believe that the Authority is the appropriate body to supervise but within a specialised team with appropriate skills.</p> <p>There is a general feeling that a one-size- fits-all approach is not the right one and that crypto-assets should be divided into different categories and</p>	<p>The Authority recognises that, should any parts of the sector become regulated, that it will need to obtain the appropriate technical resources and skills prior to supervising the sector.</p> <p>The Authority's approach to regulation is technology neutral in that it considers the substance of the activity being undertaken rather than its legal form. Where the features of a crypto-asset activity meet the definition of a current regulated activity (such as electronic money) the appropriate regulatory framework already applies to the persons carrying on that activity.</p>

supervised separately, such as where tokens used for gambling or investing.

### Question 3

Please explain if you feel there are any types of crypto-asset business that should, or should not, be regulated? Please explain why you consider this to be the case?

#### Responses received (in summary)

Most respondents agreed that crypto-asset service providers which exchange fiat currency to crypto-assets and back to fiat should be regulated.

Apart from this specific business model, there was little consensus around what activities should be within the regulatory perimeter and which activities should be excluded or exempted.

#### Authority's response

The Authority recognises that the sector is rapidly developing and it is not realistic to bring all crypto-asset service providers within the regulatory perimeter when new developments, such as NFTs, may not clearly fit within existing definitions.

If any part of the sector is to become regulated, the Authority will consult fully on any proposed exemptions and exclusions at that time.

### Question 4

Please let us know your views on each of the implications of regulation set out above<sup>1</sup>. Please explain what type of stakeholder you are (i.e. consumer / CVC business / other Isle of Man business, Government Department, etc.), and whether you consider there are other implications which the Authority should consider. If so, what are they?

#### Responses received (in summary)

All respondents agreed that any crypto-asset business that may in future be licensed in the Island must be managed and controlled in the Island and have sufficient economic substance here.

All respondents also agreed that, if crypto-asset service providers were to be regulated, this would help to

#### Authority's response

The Authority recognises that the fact a business is regulated offers a degree of comfort and reassurance to consumers, making it more likely that the services of a regulated firm will be used over that of an unregulated firm. Therefore any regulation has to be of a sufficient nature to provide that comfort to consumers, rather than only being a marketing point.

<sup>1</sup> [Page 9 of the Request for Input – Innovation and the Regulatory Perimeter](#)

encourage customers to use their services over an unregulated business located elsewhere.

Some respondents felt that the direct and indirect costs in the Island are high, specifically around obtaining technical expertise and recruiting appropriate staff, which are in short supply. The costs associated with accessing banking services (where possible) are also considered to be high. Respondents felt that regulation may give the sector credibility and serve to bring some of the costs down, through a larger client base and a reduced risk perception from other stakeholders such as banks.

Some respondents feel that regulation should be “competitive” in order to give Isle of Man firms a competitive advantage on the global stage and that regulation must not stifle businesses seeking to grow.

The commercial impact regulation has on a firm will always be considered and minimised where possible, however in developing any regulatory framework the Authority will focus on reducing the risk of harm to consumers, the risk of financial crime and the threats to the Island’s reputation.

Access to technical skills and the cost of employing people with the appropriate skills is recognised as an issue for this sector. Whilst regulation may indirectly reduce some of these costs, it is not guaranteed and may actually also increase resource pressures, such as compliance personnel, further increasing costs.

**Question 5**

Do you feel that by expanding regulation there would be a net potential benefit / growth to the economy, and if so is it sufficient to justify adding additional risks to the reputation of the Island as an international financial centre?

**Responses received (in summary)**

Most respondents felt that regulation would be net-positive because it gives crypto-asset businesses the ability to provide some comfort and assurance to customers, however all were keen

**Authority’s response**

Whilst the Authority recognises that a business being regulated will likely give some reassurance to customers, it is important to understand that the regulatory framework exists to protect consumers, reduce financial crime and



<p>to stress that the regulation must not stifle the growth of the business.</p> <p>Some respondents felt that the reputational impact of a high profile failure would be detrimental to the Island's reputation and that regulation would reduce this risk so providing a net benefit to the Island.</p>	<p>protect the Island's reputation as a financial centre.</p> <p>In developing a regulatory regime, the Authority will be mindful of the impact the framework would have on a business, however this cannot be to the detriment of its regulatory objectives.</p>
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### Question 6

Specifically in relation to costs - do you want to contribute to funding the establishment of a regime, and does your response differ if the potential benefits / growth to the economy are either negative or small?

#### Responses received (in summary)

All of those who responded to this question offered non-financial support such as technical expertise in developing an appropriate framework.

Most respondents agree that, if licensed, the sector should be funded by a levy, tax or licence fee on the crypto-asset service providers themselves and they should cover the costs of their own supervision.

#### Authority's response

The Authority is pleased to have this support available.

The Authority's funding model is based on principles which include the aim for fees to be set at a level that recovers regulatory and oversight costs from each sector.

### Question 7

Please let us know what you consider the benefits of regulation of crypto-asset businesses are, in terms of "a strong and diverse economy" as set out in the Isle of Man Government's draft Island Plan (please focus on the benefits of the regulation, not the benefits of the businesses themselves, because those benefits are already available due to those businesses already being able to establish in the Island under the AML/CFT registration regime).

#### Responses received (in summary)

Most respondents recognise that the crypto-asset industry is here for the

#### Authority's response

The Authority maintains a watching brief of international developments in the

long term and that as other jurisdictions around the world develop regulatory regimes, the Island should stay in step with the international community.

However, some respondents noted that now may not be the right time to introduce a full regulatory framework because the Island does not have the enough people with the technical skills available nor does it have the wider financial infrastructure in place such as sufficient local access to banking or insurance services for the sector to flourish. Many of the respondents stated that the introduction of a regulatory framework may mean that financial service providers such as banks and insurers could re-consider serving the crypto-asset sector.

regulation of crypto-asset service providers.

A full regulatory regime, such as that proposed by the EU's Markets in Crypto Assets, would require a full regulatory regime to be put in place; including the segregation of client assets in a recognised bank and having appropriate professional indemnity insurance in place. If such requirements were in place, but the services were not practically available to the sector this would mean those businesses could not meet basic licence requirements and potentially result in their closure.

Whilst it is accepted that crypto-asset service providers being regulated *may* result some of these service providers offering more services to that sector, this is not a guaranteed outcome.

#### 4 GLOBAL PROPOSALS

The Authority maintains a watching brief of regulatory developments of crypto-asset service providers. In addition to the feedback from this Request for Input, the Authority has considered a number of regulatory frameworks which have been, or are currently being implemented by other jurisdictions including:

- Full regulation of issuers of stablecoins which are not electronic money;
- Full regulation of crypto-asset exchanges and custodians only;
- Partial regulation of crypto-asset exchanges, custodians and issuers of crypto-assets;
- Implementation of the EU's Markets in Crypto Assets proposals.

The majority of international regulatory regimes are still under development or are relatively newly implemented, making it difficult to assess the long term effectiveness of one type of regime over another. Therefore, the Authority is of the view that it should continue to maintain a watching brief and observe how these regimes settle and mature,

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before adopting elements from those regimes which are effective and proportionate for the Island.

## **5 OUTCOME AND NEXT STEPS**

It is considered that there is merit in introducing a regulatory regime for some types of crypto-assets businesses at an appropriate time, and the responses received to the Request for Input shows that there is some public support for such a move.

However, given that there are a number of substantially different regimes currently under development and all are facing practical hurdles for which there is not yet a clear solution, the time is not right to make a firm decision on the breadth of regulation to introduce.

The Authority will continue to maintain a watching brief on how this sector, and the regulatory frameworks, develop and mature. Any proposed updates to the regulatory perimeter will be subject to full consultation before introduction.

In case of any query, please contact —

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