



**ISLE OF MAN
FINANCIAL SERVICES AUTHORITY**

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**Request for Input
Innovation and the Regulatory Perimeter**

DP22-01

Issue Date: 21 February 2022

Closing Date: 18 April 2022

Request for Input – DP22-01

This Request for Input is issued by the Isle of Man Financial Services Authority ('Authority'), which is the regulatory body for financial services in the Isle of Man. Its purpose is to seek information and opinion on the implications of innovation in connection with certain activities which are currently not regulated.

This Request for Input is relevant to Government Departments and Statutory Boards and all businesses and individuals with a nexus to the Isle of Man.

The closing date for submissions is 18 April 2022.

Please send submissions in writing and preferably by email to:

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Confidentiality and Data Protection

The information you send may be published in full or in a summary of submissions. All information in submissions, including personal data, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2015 and the Data Protection Act 2018). If you want your submission to remain confidential, you should explain why confidentiality is necessary. Your request will be acceded to only if it is appropriate in the circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding. The Authority is registered with the Information Commissioner as a data controller under Isle of Man data protection legislation. It collects and processes personal data to carry out its functions under relevant legislation and may share personal data with other parties where there is a legal basis for doing so. Further information on how the Authority collects and processes personal data can be found in the Privacy Policy on the Authority's website: <https://www.iomfsa.im/terms-conditions/privacy-policy/>.

If you have a query in relation to how this Request for Input has been carried out, please contact the Authority's Policy and Authorisations Division by email at Policy@iomfsa.im or by telephone on +44 (0) 1624 646000.

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Glossary

AML/CFT	Anti-money laundering / Countering the financing of terrorism
Authority	Isle of Man Financial Services Authority
Crypto-assets / CVC	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
DBROA15	Designated Businesses (Registration and Oversight) Act 2015
Designated Businesses	Persons registered with the Authority under the DBROA15
Distributed Ledger / DLT	A ledger which is distributed across a number of computers which records the creation of and changes to crypto-assets. Changes to the crypto-asset may only be made if the change is authenticated by a majority of the network through the use of cryptographic algorithms. This allows for changes to the network to be made without the permission of a central authority.
FSA08	Financial Services Act 2008
IA08	Insurance Act 2008
IT	Information technology
RBSA2000	Retirement Benefits Schemes Act 2000
Regulated entity	<p>This term is used to mean any of the following:</p> <ul style="list-style-type: none"> • a licenceholder under the FSA08; • persons authorised or registered under the IA08; • permit holders, other than EU permit holders, under the IA08; • persons registered under the RBSA2000; • corporate trustees of authorised retirement benefits schemes; or • the governing bodies of certain collective investment schemes

1. Background and Context

1.1 Overview

Innovation is a term that is often used in connection with recent and ground-breaking IT developments, such as crypto-assets and distributed ledger technology, but can equally apply to simply doing something in a new or different way to the way it has been done to date (often using technological advances).

The Authority welcomes and supports innovation, having a moderate tolerance of the risks that technology and fintech advances may bring. Innovation has the potential to bring benefits and reduce an entity's risks and costs and enhance consumer protection and choice.

In its most recent Annual Report, the Authority stated, *"We will work together with industry and with the Digital and Finance Agencies of the Department of Enterprise to identify issues and opportunities in new business models and technology impacting the regulatory framework"* and *"We will work with industry to identify practical solutions which ensure that the Authority's regime remains appropriate for new business models and technologies, whilst addressing risk."*

The Authority is open to the benefits of innovation and is a member of GFIN¹. We are currently considering the issue of innovation linked to crypto-assets, which is outside of the regulatory remit at this time, and what this means for various stakeholders including the Isle of Man Government, regulators, businesses and consumers.

1.2 What is the purpose of this Request for Input?

The purpose of this request is to develop our knowledge by seeking information and opinion from a wide range of interested parties on the implications of innovation in connection with certain activities that are currently not regulated.

The information received will assist the Authority shape its understanding and inform future considerations on which activities could or should be brought within the regulatory perimeter.

1.3 Who may be affected by this Request for Input?

Government Departments and Statutory Boards and all businesses and individuals with a nexus to the Isle of Man could have useful views and data that will assist the Authority. Ultimately, the outcome of the research and the Authority's wider consideration of innovation could impact a variety of stakeholders such as Government bodies, regulated entities, designated businesses, other businesses and individuals who are customers of the above.

¹ Global Financial Innovation Network

2. Input Process

2.1 The Authority's regulatory objectives

The Authority's regulatory objectives are set out in section 2(2) of the FSA08 —

- (a) securing an appropriate degree of protection for policyholders, members of retirement benefits schemes and the customers of persons carrying on a regulated activity;
- (b) the reduction of financial crime; and
- (c) the maintenance of confidence in the Island's financial services, insurance and pensions industries through effective regulation, thereby supporting the Island's economy and its development as an international financial centre.

The Authority is required to give consideration to certain factors when discharging its functions in accordance with paragraph 3 of Schedule 1 to the FSA08. The most relevant factors for this request are considered to be as follows:

Factor
The need for the regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden.
The need to use resources in an efficient and economic way.
The need to safeguard the reputation of the Island.
The impact of its decision on the stability of the financial system of the Island.

2.2 Responding to the Request for Input

Open dialogue with stakeholders is essential to assist the Authority in broadening its knowledge of this topic and to help it determine any next steps. Constructive engagement will help the Authority reach an informed view. Respondents should note the following when responding to this request:

- As submissions may be subject to publication or disclosure in accordance with access to information regimes, respondents should state if they wish their submissions to remain confidential and, if so, the reasons for this.
- Submissions should be received by the closing date of the Request for Input to be considered.
- Professional bodies, trade associations and other representative groups should provide a summary of the people and organisations they represent when responding to the request as well as the methodology used to gain members' input.
- Please do not make anonymous submissions as they will not be considered or included in the Feedback Statement.

This Request for Input has been published on the Authority's website and the Isle of Man Government's Consultation Hub².

3. Crypto-asset / CVC Businesses

Crypto-asset businesses are not regulated by the Authority. Such businesses are only registered with the Authority, under the DBROA15, and are a type of designated business.

Registration under the DBROA15 means that the Authority oversees the entity purely in relation to whether it is adhering to the Island's AML/CFT legislation. There are no elements of regulation involved, nor of consumer protection. However, due to the increased AML/CFT risks of crypto-assets and to ensure AML/CFT oversight can effectively take place, the Authority imposes a condition of registration on all such businesses to require that their management and control is in the Isle of Man.

3.1 Types of crypto-asset businesses

There are approximately 20 crypto-asset businesses registered with the Authority as designated businesses, additionally some entities that are regulated by the Authority have links with crypto-assets or digital ledger technology. The crypto-asset activities currently taking place in or from the Island as designated businesses under the AML/CFT registration regime include:

- crypto-asset exchanges – which provide facilities to trade fiat currencies and crypto-assets for other crypto-assets;
- crypto-asset custodians – which provide facilities designed to securely store crypto-assets;
- lenders – taking crypto-assets as collateral;
- general crypto-asset businesses – involved in Non Fungible Tokens;
- initial coin offerings – by which businesses raise funds for various purposes.

A small amount of crypto-asset business is already subject to financial services regulation in the Island if it amounts to a defined regulated activity (such as the issuance of e-money via stablecoins, or where the 'token' is a security). If it were determined to broaden the regulatory perimeter to encompass some CVC activities that can currently be performed under a designated business registration, it may be appropriate to do so in relation to certain of those CVC activities, but not all.

The Authority is aware of some jurisdictions that already regulate certain crypto-asset activity (such as Gibraltar and Bermuda), as well as plans in other jurisdictions (such as the EU and the UK) to potentially broaden regulation to include some crypto-asset businesses; for example, crypto-exchanges, persons providing advice on crypto purchases, crypto safe custody wallets and initial coin offerings. Each of these areas has different risks, but all involve some element of risk to consumers.

² <https://consult.gov.im/>

Q1 – 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?

Q2 – 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.

Q3 – 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?

3.2 Implications of regulation

There have been some soundings for the ‘perimeter of regulation’ to be broadened to include some crypto-asset businesses. However, it is not known whether this is from a desire by such firms to ‘market’ on the basis of being regulated, rather than with a clear understanding of what being regulated fully involves. To provide appropriate regulation is a cost and it is unclear what the benefit of that regulation would be for the Island, in terms of economic growth, to balance that expenditure. The regulatory regime’s purpose is to protect consumers, the Island’s reputation and to help prevent financial crime.

Regulation means stringent requirements for all regulated entities are in place, concerning matters such as the amount of capital and liquid assets that must be maintained at all times, the qualifications and competence of the business’ staff, the need for a full local presence on the Isle of Man, including management and control as well as the physical presence of persons undertaking the regulated activity, the fitness and propriety of individuals in certain roles, the protection of client assets, corporate governance and disclosure, etc. Having requirements in these areas is necessary to achieve our regulatory objectives. Additionally, regulatory regimes tend to expand over time as experience is gained. Any regulation is likely only to ever increase its requirements over the longer term.

The Authority is very keen to be provided with the views of crypto-asset businesses in relation to potential regulation, and how those in such businesses feel about the implications of potential regulation, the inevitable costs involved and what the benefits would be for them and also in terms of “a strong and diverse economy” for the Island as set out in the Isle of Man Government’s draft Island Plan³.

We are also keen to hear from other stakeholders, including customers and potential customers of such businesses, in the knowledge that certain implications may be seen as positive by some stakeholders and negative by others. The table below sets out some matters (not exhaustive) that the Authority feels could be important implications of broadening the perimeter of regulation:

³ <https://www.tynwald.org.im/business/opqp/sittings/20212026/2021-GD-0085.pdf>

Implications
A. Regulation requires a real and substantial presence on the Isle of Man – this could mean more and diverse employment opportunities.
B. The fact of regulation may encourage persons to become clients of regulated businesses.
C. Regulation can provide some protection, for example prohibiting certain activities with certain types of customer, but despite regulation business can and will fail, and the value of crypto-assets is volatile and high-risk.
D. Regulation does not provide an ‘eco-system’. Businesses need to have a reason to establish on the Isle of Man, as well as business premises, staff with expertise, third party advisers, banking and audit facilities, etc.
E. Consumers take comfort from an activity being regulated. Therefore the regulatory requirements must be stringent and sufficient to address consumer detriment and provide a real reason for the comfort.
F. Regulation has a significant cost. Businesses have costs of ‘compliance’ and penalties for non-compliance. Regulators have high costs in establishing a regime and supervising that regime. The establishment of a regime would need to be funded by Government and / or existing businesses. The regulator requires sufficient regulatory resources, including appropriately trained and experienced staff. Ongoing regulatory costs would have to be predominantly funded by the relevant industry, which may not be of a sufficient size or profitability to afford this.
G. There is uncertainty whether the substantial upfront ‘establishment of regime’ costs would be justifiable, and translate into sufficient economic activity in the future to be a net benefit to the Island.
H. Regulation naturally applies boundaries and requirements. These can change but such boundaries may deter or stifle new developments before they have had a chance to flourish. Full regulation and supervision is likely to result in fewer crypto-asset businesses being able to meet this high hurdle, compared to the current number of such businesses that are able to comply with the ongoing requirements of the AML/CFT only registration, and could result in a decrease in the number of such businesses on the Island.

Q4 - Please let us know your views on each of the implications of regulation set out above. 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?

Q5 – 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?

Q6 – 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?

Q7 – 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).

4. Questions

Question 1

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?

Question 2

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.

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?

Question 4

Please let us know your views on each of the implications of regulation set out above. 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?

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?

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?

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).

5. Next Steps

Following closure of the Request for Input period, the Authority will review the responses received and publish a Feedback Statement on the Authority’s website and the Isle of Man Government’s Consultation Hub.

Additionally, the Authority will liaise with some stakeholders directly, via fora and open discussions, both during and after the period covered by this Request for Input, in order to increase its knowledge about the nature of innovation taking place in the Isle of Man.