



# **BERMUDA MONETARY AUTHORITY**

## **CONSULTATION PAPER**

### **CONDUCT OF BUSINESS REGULATORY REGIME:**

### **DIGITAL ASSET BUSINESS ACT 2018: CODE OF PRACTICE & DIGITAL ASSET BUSINESS (CLIENT DISCLOSURE) AMENDMENT RULES 2022**

**OCTOBER 2022**

## TABLE OF CONTENTS

<b>I. Introduction</b> .....	<b>3</b>
<b>II. Application and Purpose of Proposals</b> .....	<b>3</b>
<b>III. Conclusion</b> .....	<b>4</b>

APPENDIX I - DRAFT DIGITAL ASSET BUSINESS ACT 2018 CODE OF PRACTICE

APPENDIX II - DRAFT DIGITAL ASSET BUSINESS (CLIENT DISCLOSURE) AMENDMENT  
RULES 2022

The Bermuda Monetary Authority (Authority or BMA) invites licensed Digital Asset Businesses (DAB) and other stakeholders to submit their views on the proposals set out in this paper. Stakeholders should send comments to [conduct@bma.bm](mailto:conduct@bma.bm) no later than **19 December 2022**.

## **I. INTRODUCTION**

1. The Authority is committed to enhancing its regulatory regimes to ensure they remain appropriate for the financial sectors it regulates and supervises. To this end, one of the Authority's key strategic initiatives includes establishing a conduct of business regulatory framework, which ensures protection for customers using the services of regulated financial institutions.
2. In exploring the policy proposals to shape this framework, the Authority recognises the importance of applying appropriate customer protection measures in proportion to observed risks in the market. The Authority has sought to engage with industry stakeholders to codify market best practices. In doing so, the Authority remains cognisant of the DAB sector's uniqueness and fast-changing nature. It aims to account for this in the proposals to continue allowing for innovative business models while ensuring appropriate client protections.
3. The Consultation Paper (CP) published by the Authority in December 2020 entitled *Consultation Paper: Conduct of Business Regulatory Regime* (2020 CP) outlined the principles for good conduct of business (Principles).<sup>1</sup>
4. As stated in the 2020 CP, the Authority is taking a phased implementation approach. It will now embed the Principles into the Digital Asset Business Act 2018 Code of Practice (CoP) and the Digital Asset Business (Client Disclosure) Rules 2018 (Client Disclosure Rules), which are respectively issued under Sections 6 and 7 of the Digital Asset Business Act 2018 (DABA).
5. This CP seeks feedback on the proposed amendments to the CoP and the Client Disclosure Rules, attached hereto as Appendix I and II, respectively. Feedback regarding the suggested amendments' applicability to all business models within the sector is welcome. The Authority acknowledges that information disclosure to clients and interactions with clients in a largely non-face-to-face setting is the norm in this sector and would appreciate feedback on the practicalities of applying the suggested provisions guiding client interactions.

## **II. APPLICATION AND PURPOSE OF PROPOSALS**

6. The CoP's provisions apply to all DABs licensed under Section 12 of DABA. The CoP is of general application and seeks to take account of the wide diversity of DABs that may be licensed.
7. In assessing the existence of sound and prudent business conduct, the Authority will have regard for the appropriateness of the CoP's provisions regarding its application to a particular licensee, considering the licensee's nature, scale and complexity and the Authority's supervisory objectives. The Authority will assess adherence to the CoP and

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<sup>1</sup> <https://www.bma.bm/viewPDF/documents/2020-12-15-13-29-14-Consultation-Paper---Proposal-for-a-Conduct-of-Business-Regulatory-Regime.pdf>

compliance with the Client Disclosure Rules as part of its ongoing on-site inspections and off-site surveillance of licensed DABs.

8. Where appropriate, DABs are afforded the flexibility to design and implement their policies and procedures to ensure optimal outcomes for their clients, while allowing innovation and reflecting each institution's unique business profile.
9. The Authority proposes to amend the CoP to largely consolidate existing and new conduct of business-related provisions, notwithstanding the wider conduct provisions already within the CoP. The rationale of this approach is to provide clear visibility to both DAB licensees and their clients of the licensee's obligations to conduct their affairs in line with the Principles. The amendments seek to ensure that, among other things, all DABs:
  - a) Have an obligation to treat clients fairly and equitably;
  - b) Have continuing regard for the interests of clients in the conduct of their business;
  - c) Ensure that communications with clients are fair, clear and not misleading;
  - d) Provide the necessary protection against the loss of clients' assets due to internal fraud or misuse;
  - e) Handle complaints and errors fairly and expediently;
  - f) Ensure that clients, especially retail clients, are aware of their responsibilities within the business relationship and facilitate access to appropriate resources to help them understand their responsibilities within the business relationship.
10. Additionally, the Authority proposes to amend the Client Disclosure Rules, specifically deleting the existing sub-paragraph (g)(vi) of paragraph 3(3) and replacing it with a new sub-paragraph (g)(vi), which outlines circumstances where a DAB is required to notify a client of information changes.

### III. CONCLUSION

11. In amending the CoP and Client Disclosure Rules, the Authority will formalise its oversight of the conduct of DABs licensed under DABA to secure appropriate protection for their clients and encourage best practices within the DAB sector.
12. The Authority invites stakeholders to contribute their views on the proposals set out in this paper. Stakeholders should send comments to [conduct@bma.bm](mailto:conduct@bma.bm) no later than close of business on **19 December 2022**.
13. After receiving all such feedback, the Authority will look to make any necessary amendments to the draft CoP and Client Disclosure Rules, which will be finalised for issuance. The BMA will provide a suitable transition period and communicate this to the relevant entities.

**APPENDIX I - DRAFT DIGITAL ASSET BUSINESS ACT 2018 CODE OF PRACTICE**



# **BERMUDA MONETARY AUTHORITY**

**DIGITAL ASSET BUSINESS ACT 2018**

**CODE OF PRACTICE**

**xx 2023**



## Table of Contents

I. INTRODUCTION.....	5
II. PROPORTIONALITY PRINCIPLE .....	5
III. CORPORATE GOVERNANCE .....	6
3.1 The board.....	6
3.2 Oversight responsibilities of the board .....	7
3.3 Responsibility of the chief and senior executives .....	8
IV. SENIOR REPRESENTATIVE .....	9
V. RISK MANAGEMENT FRAMEWORK.....	10
5.1 Risk management function .....	10
VI. CLIENT DUE DILIGENCE AND MONITORING.....	11
VII. INTERNAL MANAGEMENT CONTROLS.....	12
7.1 Segregation and protection of client assets.....	12
7.2 Competent and effective management.....	12
7.3 Delegation.....	13
7.4 Accounting and other record-keeping .....	13
7.5 Adequate personnel.....	13
7.6 Cyber risk.....	13
7.7 Internal audit function .....	14
7.8 Compliance function .....	15
7.9 Self-assessment .....	15
7.10 Operational risk incident reporting .....	16
VIII. OUTSOURCING.....	16
IX. CONDUCT OF BUSINESS.....	17
9.1 Integrity and ethics .....	17
9.2 Conflicts of interest.....	18
9.3 Fair treatment of clients .....	19
9.4 Vulnerable clients .....	19
9.5 Product due diligence .....	19

9.6 Advertising and promotions .....	21
9.7 Sales practices.....	21
9.8 Communications with clients.....	21
9.9 Disclosure of information.....	22
9.10 Suitability .....	22
9.11 Clear client responsibilities .....	23
9.12 Client awareness.....	23
9.13 Client agreements.....	24
9.14 Conducting business over the internet.....	24
9.15 Preservation of confidentiality .....	25
9.16 Client complaint handling .....	25
Closed accounts and inactive accounts .....	26
9.17 .....	26
X. COOPERATION WITH REGULATORY AUTHORITIES .....	27
II. INTRODUCTION.....	3
III. PROPORTIONALITY PRINCIPLE .....	3
IV. CORPORATE GOVERNANCE .....	4
The board.....	4
Oversight responsibilities of the board.....	5
Responsibility of the chief and senior executives .....	6
V. SENIOR REPRESENTATIVE .....	7
VI. RISK MANAGEMENT FRAMEWORK .....	7
Risk management function.....	8
VII. CLIENT DUE DILIGENCE AND MONITORING .....	9
VIII. CONDUCT OF BUSINESS.....	9
Integrity and Ethics.....	9
Conflicts of Interest .....	10
Fair treatment of clients .....	11
Vulnerable clients .....	11
Product Due Diligence .....	11
Advertising and Promotions .....	12
Sales practices.....	13
Communications with clients.....	13
Disclosure of Information.....	13

Clear consumer responsibilities .....	14
Client awareness .....	14
Client agreements .....	15
Conducting business over the internet .....	16
Suitability .....	17
Preservation of confidentiality .....	17
Client complaint handling .....	17
IX.— INTERNAL MANAGEMENT CONTROLS .....	18
Segregation and protection of client assets .....	18
Competent and effective management .....	19
Delegation .....	19
Accounting and other record-keeping .....	19
Adequate personnel .....	19
Cyber security programme .....	20
Internal audit function .....	22
Compliance function .....	22
Self-assessment .....	23
X.— OUTSOURCING .....	24
XI.— COOPERATION WITH REGULATORY AUTHORITIES .....	24

## **I. INTRODUCTION**

1. This Code of Practice (Code) is made pursuant to Section 6 of the Digital Asset Business Act 2018 (Act). Section 6 requires the Bermuda Monetary Authority (Authority or BMA) to publish, in such manner as it thinks fit, a code that provides guidance on the duties, requirements, procedures, standards and sound principles to be observed by persons carrying on Digital Asset Business (DAB).
2. Failure to adhere to the provisions set out in the Code will be taken into account by the Authority in determining whether a licensed DAB is meeting its obligation to conduct its business in a sound and prudent manner.
3. The Code should be read in conjunction with the DAB Statement of Principles issued under Section 5 of the Act.

## **II. PROPORTIONALITY PRINCIPLE**

4. The Authority appreciates that DABs have varying risk profiles arising from the nature, scale, complexity and risk profile of the business, and that those DABs with higher risk profiles would require more comprehensive governance and risk management frameworks to conduct business in a sound and prudent manner.
5. Accordingly, the Authority will assess the DAB's adherence to the Code in a proportionate manner relative to its nature, scale, complexity and risk profile. These elements will be considered collectively, rather than individually (e.g., a DAB could be relatively small in scale, but carry out extremely complex business and, therefore, would still be required to maintain a sophisticated risk management framework). In considering these elements:
  - a. Nature includes the relationship between clients and the DAB or characteristics of the service provided (e.g., a DAB that takes custody of a client's assets versus one that does not);
  - b. Scale includes size aspects, such as volume of the business conducted or the size of the balance sheet in conjunction with materiality considerations (e.g., an assessment of the impact of a DAB's failure); and
  - c. Complexity includes items such as organisational structures and product design.
6. In assessing the existence of sound and prudent business conduct, the Authority will have regard for both its prudential objectives and the appropriateness of each Code

provision for the DAB, taking into account that DAB's nature, scale, complexity and risk profile.

7. The proportionality principle, discussed above, is applicable to all sections of the Code regardless of whether the principle is explicitly mentioned.

### **III. CORPORATE GOVERNANCE**

8. The DAB must establish and maintain a sound corporate governance framework, which provides for appropriate oversight of the DAB's business and adequately recognises and protects the interests of clients. The framework should have regard for international best practice on effective corporate governance. Corporate governance includes principles of corporate discipline, transparency, accountability, responsibility, compliance and oversight.
9. The ultimate responsibility for sound and prudent governance and oversight of the DAB rests with its board of directors or equivalent governing body (board). In this regard, the board is responsible for ensuring corporate governance policies and practices are developed and applied in a prudent manner that promotes the efficient, objective and independent judgment and decision-making by the board. The board must also have adequate powers and resources to be able to discharge its duties fully and effectively.

#### **3.1 The board**

10. The Authority recognises that the board plays a critical role in the successful operation of a DAB. The board is chiefly responsible for setting corporate strategy, reviewing and monitoring managerial performance, and determining an acceptable level of risk. Therefore, the effectiveness of the DAB's board is a basic tenet of the Authority's risk-based supervisory approach. Pragmatically, the board will likely delegate tasks; however, the delegation of authority to board committees, chief and senior executives, employees, or external parties does not absolve the board from its ultimate responsibilities.
11. The board must ensure the business is effectively directed and managed, and conducted in a professional manner with appropriate integrity and due care. It is the responsibility of the board to ensure that processes exist to assess and document the fitness and propriety of its members, controllers and officers. The board must also take into account the fact that conflicts of interest, or potential conflicts of interest, may on occasion preclude the involvement of specific individual members on particular issues or decisions.

12. To effectively discharge its duties, the board must have an appropriate number and mix of directors to ensure that it has the requisite experience, knowledge, skills and expertise commensurate with the nature, scale, complexity and risk profile of the DAB's business.
13. Individual board members must:
  - a. Act in good faith and honestly and reasonably exercise due care and diligence;
  - b. Ensure the interests of clients are protected;
  - c. Exercise independent judgment and objectivity in their decision-making; and
  - d. Ensure appropriate policies and procedures exist to effectively deal with conflicts of interest.

### **3.2 Oversight responsibilities of the board**

14. As the DAB's governing body, a key board responsibility is setting appropriate strategies and overseeing implementation. This includes ensuring that chief and senior executives establish a framework to implement the DAB's strategic business objectives.
15. The board is also responsible for providing suitable oversight of the DAB's governance, risk management and internal controls frameworks, including any activities and roles that are delegated or outsourced. A list of oversight responsibilities that the board must consider when establishing and assessing the effectiveness of the corporate governance framework includes ensuring the existence of:
  - a. An operational framework (including risk management, internal audit and compliance functions) to ensure adequate oversight responsibilities so that sound corporate governance exists throughout the organisation;
  - b. Processes to assess and document the fitness and propriety of board members, controllers, the chief and senior executives, senior representatives and third-party service providers, including auditors, custodians, investment managers, etc.;
  - c. Board committees (where required) to provide oversight of key operational areas, including finance and investments;
  - d. Policies and procedures to ensure adequate board oversight of the chief and senior executives;
  - e. Processes for the engagement and dismissal of the chief and senior executives and third-party service providers;

- f. Policies and procedures to manage and mitigate conflicts of interest;
- g. Processes to ensure key employees are adequately skilled to execute and discharge their duties and are compensated in a manner that encourages sound risk management, [good conduct](#) and compliance;
- h. Clearly defined charters, roles and responsibilities for the board, committees, chief and senior executives, and other key employees;
- i. Business and operational strategies, plans, budgets, and significant policies and procedures, including those surrounding oversight;
- j. Review and approval of significant policies and procedures promoting effective corporate governance across the organisation, including those for risk management and internal controls, internal audit and compliance functions;
- k. Clear documentation and regular review of processes regarding the roles and responsibilities of the board, the chief and senior executives, and other key employees delegated corporate governance responsibilities (including appropriate segregation of the oversight function from management responsibilities);
- l. Adequate independence for the risk management, internal audit and compliance functions to assist in oversight responsibilities and ensure these functions have a direct communication channel to the board and relevant committees; and
- m. Processes to confirm that the board has appropriate access to accurate, relevant, and timely information to enable it to carry out its duties and functions, including the monitoring and review of the performance and risk exposures of the DAB and the performance of the chief and senior executives.

### **3.3 Responsibility of the chief and senior executives**

16. Given the important roles these individuals play, the board must ensure that great care is taken in the selection of the chief and senior executives. In addition to supporting the board, the chief and senior executives are also responsible for the prudent administration of the DAB. Such responsibilities include:
- a. Managing and executing the day-to-day operations of the DAB, subject to the mandate established by the board and the laws and regulations in the operating jurisdiction;

- b. Assisting the board to develop and implement an appropriate control environment, including those around reporting and security systems;
  - c. Providing recommendations on strategic plans, objectives and key policies and procedures to the board for evaluation and authorisation;
  - d. Assisting the board with its oversight responsibilities by ensuring that the board has accurate and timely information, allowing the board to conduct robust and candid discussions on operational performance, strategy and major policies, and to appraise the performance of management;
  - e. Supporting oversight of both internal control functions (e.g., risk management, internal audit and compliance) and external third-party services;
  - f. Ensuring that key functions assigned corporate governance responsibilities are supported with adequate resources to execute and discharge their duties;
  - g. Ensuring that external service providers, including approved auditors, have adequate resources and information to fulfil their role, including access to timely and accurate internal and outsourced records; and
  - h. Ensuring the proper vetting of all staff.
17. Given the governance responsibilities, where requirements are imposed upon the DAB throughout the Code, the Authority will look to and expect the chief and senior executives, and ultimately the board, to ensure adherence.

#### **IV. SENIOR REPRESENTATIVE**

18. The role of the approved senior representative is integral to the BMA's DAB supervisory and regulatory framework. While the DAB's board and the chief and senior executives have primary responsibility for the conduct and performance of the DAB, the approved senior representative acts in an "early warning" role and monitors the DAB's compliance with the Act on a continuous basis in accordance with Section 20 of the Act.
19. The Act requires every DAB to appoint a senior representative, who must maintain an [head](#)-office in Bermuda. The appointed senior representative must be knowledgeable in digital asset business and related Bermuda laws and regulations.
20. The approved senior representative would generally be a director or senior executive of the DAB who, under Section 20 of the Act, has the legislated duty to report certain events to the Authority.

21. The board and chief and senior executives must make arrangements to enable the approved senior representative to undertake his or her duties pursuant to the Act in an efficient and effective basis, including providing access to relevant records.

## **V. RISK MANAGEMENT FRAMEWORK**

22. The board and the chief and senior executives should, based on their judgement, adopt an effective risk management and internal controls framework. The framework should have regard for international best practice on risk management and internal controls. This includes ensuring the fitness and propriety of individuals responsible for the management and oversight of the framework.

### **5.1 Risk management function**

23. The DAB must establish a function to assist it with the oversight responsibility of the organisation's risk management framework. Depending on its risk profile, the function may be headed by a chief risk officer or the responsibilities assigned to, or shared among, the DAB's operational unit leaders. Regardless, there should be a mechanism to allow direct reporting to the board or its established committees.
24. The risk management function should include:
- a. Clearly defined and documented roles and responsibilities that are reviewed and approved by the board on a frequent basis;
  - b. A sound and effective risk management framework, including developing (with the support of operational unit leaders) policies, procedures and internal controls promoting the timely identification, assessment, monitoring and reporting of material risks;
  - c. Key policies (e.g., risk policy, cybersecurity policy, client private key storage policy and policies required under the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008 (POCR) and effectiveness and compliance assessments with established benchmarks, such as risk appetite and risk tolerance limits;
  - d. Measurement techniques, such as benchmarking or stress and scenario testing;
  - e. Regular review of the risk management techniques employed in light of changing operational, regulatory and market developments to ensure continued effectiveness and adoption of international best practice; and

- f. Operation policies for the transfer of assets between wallets, which requires additional signatures from senior management based on the amount being transferred.
25. Risk management, risk identification, risk assessment, risk monitoring and risk reporting are critical for an effective risk management framework. As such, the DAB must implement these in an effective manner for the benefit of the DAB's stakeholders and to support its business objectives.

## **VI. CLIENT DUE DILIGENCE AND MONITORING**

26. Industry participants, including clients, have the potential to adversely impact a jurisdiction's reputation and bring harm to society at large. Accordingly, the DAB must have procedures in place to ensure that proper due diligence is carried out before a decision is made to act for any new client. At a minimum, the DAB needs to be able to comply with the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing Supervision and Enforcement) Act 2008, the POCA and the Anti-Terrorism (Financial and Other Measures) Act 2004, together with any other relevant legislation that may come into force from time to time.
27. The duty of vigilance includes verification, recognition and reporting of suspicious transactions; the keeping of "know your client records"; and delivering the appropriate Anti-Money Laundering (AML) training to all staff. The DAB must ensure that its procedures enable it to determine and verify the true identity of clients requesting its services. Copies of photo identification such as a driver's licence or passport should be retained in compliance with the Proceeds of Crime Act 1997 and relevant guidance notes and codes. The DAB must undertake due diligence checks on clients to protect against illegal activity, including money laundering and terrorist financing.
28. Where appropriate, measures that the DAB should consider putting in place to minimise the risk of abuse, include (depending upon client risk ratings) appropriate standard rules relating to maximum individual transaction sizes for its different digital asset services. In such cases, the DAB should have the ability to collate and aggregate individual transactions that may form part of a larger transaction and may be intended to avoid standard limits or reporting requirements.
29. The DAB must maintain detailed records for both sides of a transaction that include: information to identify the parties, the public key addresses or accounts involved, the nature and date of the transaction, and the amount transferred. The DAB must monitor transactions for the purpose of detecting those that lack originator or beneficiary

information, and take appropriate measures. These measures may include taking action to freeze an account or to prohibit conducting transactions with designated persons and entities.

## **VII. INTERNAL MANAGEMENT CONTROLS**

30. The board and the chief and senior executives must review and assess the effectiveness of the internal reporting and operating controls. Any material deficiencies must be documented and resolution measures should be implemented in a timely manner. The board and the chief and senior executives should ensure the implementation of policies and procedures requiring that internal control weaknesses are reported directly to the board and chief and senior executives.

### **7.1 Segregation and protection of client assets**

31. Section 18(1) of the Act directs a DAB to ensure that any assets belonging to clients are kept segregated from the DAB's own assets. The DAB may place client assets in a trust with a qualified custodian, have a surety bond or indemnity insurance, or implement other arrangements to ensure the return of client assets in the event the DAB is placed into liquidation, becomes insolvent or is a victim of theft.

32. While keeping client assets separate from its own assets, the DAB may commingle client assets together (i.e., assets belonging to one of its clients with assets belonging to other clients), where such would benefit clients; however, proper accounting must be in place to accurately allocate each holding to the respective client.

33. The DAB must have mechanisms in place to assess its liquidity needs, including sums required for trading and other client transaction types. These mechanisms must be used to inform the DAB's client private key storage policy. The client private key storage policy should require that the majority of client private keys, not required for client transactions, should be held in cold storage to mitigate against client loss arising from cyberattacks. The Authority also expects that only a minimal balance should be kept in hot storage and that the mechanism and thresholds for transfer between hot, cold and other storages should be well documented and audited.

### **7.2 Competent and effective management**

34. The DAB should have competent management commensurate with the nature, scale, complexity and risk profile of its business. The DAB must also have appropriate

management resources to control the affairs of the licensed business, including ensuring compliance with legal obligations and standards under the Code.

### **7.3 Delegation**

35. The board may delegate the administration and other duties to directors, chief and senior executives, employees or committees as it deems appropriate. When doing so, decisions should align with authorisation and signing powers outlined in policies and procedures, and regard must also be given to stakeholder protection risks and applicable laws.

### **7.4 Accounting and other record-keeping**

36. Appropriate records must be kept and preserved in Bermuda. These records will at least include information for the DAB to effectively carry out its functions and comply with applicable laws. Systems must be in place to ensure that decision-makers, regulators, clients and other relevant stakeholders can receive requisite information in a timely manner. This should include the identity of shareholders, directors, officers or business partners. In addition, records of account and client transactions must be maintained in accordance with the applicable laws.
37. The DAB's accounting and record-keeping systems must support its compliance with regulatory reporting, such as the annual statutory and other returns, or other reporting that the Authority may require on an ad hoc basis in fulfilment of the Authority's regulatory oversight responsibilities.
38. Record-keeping requirements applicable to the DAB also apply to internet transactions.

### **7.5 Adequate personnel**

39. The DAB must have available suitable numbers of staff who are appropriately trained and competent to discharge their duties effectively. The DAB should ensure that the responsibilities and authority of each staff member are clear and appropriate given his or her qualifications and experience, and that staff receive the necessary training appropriate for their roles.
40. The DAB should ensure that it has in place systems, controls, policies and procedures, to ensure that staff members perform their duties in a diligent and proper manner. It is important that staff understand and adhere to the established systems, policies and procedures including those dealing with new business acceptance, financial transactions and staff training.

### **7.6 Cyber risk**

41. In many respects, DABs are susceptible to risks such as cyber threats or systems failure. The Code should be read in conjunction with the Digital Asset Business Custody Code of Practice and the Digital Asset Business Operational Cyber Risk Management Code of Conduct (Cyber Risk Management Code). The Cyber Risk Management Code establishes duties, requirements, standards and procedures to be complied with in relation to operational cyber risk management, and it applies to all licensed DABs.

## **7.7 Internal audit function**

42. Sound practice requires the implementation of the “three lines of defence” with the first line being risk taking, the second being risk-control and compliance, and the third being the internal audit. As such, the DAB must have an internal audit function, which should:
- a. Be segregated and staffed by persons adequately independent of operational functions, including risk management, compliance, operations and finance;
  - b. Have clearly defined and documented charters, roles and responsibilities that are reviewed and approved by the board on a regular basis and that demonstrate the independence and separation of the function;
  - c. Document material policies and procedures to be reviewed and approved by the board;
  - d. Prepare an internal audit plan to ensure assessment of governance and controls of key risk areas at appropriate intervals, taking into consideration the nature, scale, complexity and risk profile of the DAB (the internal audit plan should be reviewed at least annually and approved by the board of directors);
  - e. Have unrestricted access to all areas of the organisation, including access to any records held by third-party service providers;
  - f. Examine operational practices to ensure the adequacy and effectiveness of governance, risk management, policies, procedures and controls;
  - g. Report governance and control deficiencies directly to the board or a committee appointed by the board;
  - h. Establish a robust mechanism to monitor deficiencies until remediation efforts are completed and report remedial progress to the board at regular intervals, taking into consideration the level of risk involved;
  - i. Have appropriate authority within the organisation to ensure management addresses any internal audit findings and recommendations with respect to the adequacy and effectiveness of governance, risk management, policies, procedures and controls;

- j. Have sufficient resources and fit and proper staff to carry out duties and responsibilities;
- k. Have sufficient knowledge and experience to employ methodologies designed to assist the DAB in identifying key risks; and
- l. Assist the board in identifying areas for improvement.

## **7.8 Compliance function**

43. Regulatory and other requirements (such as internal policies and procedures) are imposed for the protection of the DAB itself, clients and stakeholders more widely. The establishment of a function focused on how well the DAB adheres to the varied requirements is valuable. The DAB must develop a function to assist it in monitoring and evaluating its compliance with jurisdictional laws and regulations, internal controls, policies and procedures. The compliance function should also promote and sustain a corporate culture of compliance and integrity.
44. The compliance function should include:
- a. Policies, procedures and processes documenting compliance with the risk management framework, legal and ethical conduct, applicable laws, rules and standards;
  - b. A system of compliance monitoring and testing, including a plan to address any deficiencies or non-compliance that may be identified; and
  - c. Training programmes for staff about compliance issues, and also a mechanism for staff to report confidentially concerns regarding compliance deficiencies and breaches.

## **7.9 Self-assessment**

45. The DAB must have a comprehensive and integrated, forward-looking view of all material and reasonably foreseeable risks that arise from its business model and interaction with the wider environment. This allows a more informed assessment of the appropriateness of its business strategy and enhances its ability to position itself for future success and sustainability. The DAB must, therefore, develop policies, processes and procedures to assess all of its material, and reasonably foreseeable, risks over its forward-looking planning horizon and self-determine its capital (both quality and quantity), liquidity and resourcing needs to inform its business strategy. The risk self-assessment must be performed at least annually and reported to the Authority. The DAB should be guided by the proportionality principle in establishing the risk self-assessment framework. Minimally, the assessment should:
- a. Be an integral part of the DAB's risk management framework;

- b. Be clearly documented, reviewed and evaluated regularly by the board and the chief and senior executives to ensure continual advancement in light of changes in the strategic direction and market developments;
  - c. Cover both (i) all material and reasonably foreseeable risks, and (ii) a forward-looking time horizon deemed appropriate by the board, having regard for the dynamics of the digital asset business industry and wider relevant influences; and
  - d. Ensure an appropriate oversight process whereby material deficiencies are reported on a timely basis and suitable actions are taken.
46. The DAB must ensure the fitness and propriety of key individuals overseeing and performing the assessment; this includes third-party service providers, if applicable, assisting with the assessment process.

### **7.10 Operational risk incident reporting**

47. A risk incident is defined as any interruption to an executed operational procedure. The cause may be known or unknown. In the event of a risk incident, a report must be generated documenting the following:
- Known cause of the incident
  - Impact of the incident
  - Incident resolution
  - The timeline of the incident, including the duration of time to resolve the incident
48. This report must be disclosed to both senior leadership and the board, and referenced for future revisions to the Operational Risk Management documented policies and procedures.
49. In the event the risk incident results in revisions or additions to standard policies and procedures, the operational risk function must establish a timeline for complying with the necessary changes and must document the compliance of meeting the goal in a timely manner.

## **VIII. OUTSOURCING**

50. While the DAB may outsource certain important business roles (such as asset management, custodial services, cyber security, compliance and internal audit) to third

parties or affiliates, such action does not remove the responsibility from the DAB to ensure that it meets all its legal and regulatory obligations~~requirements of the Act and related legislation, and this Code, and are complied with~~ to the same level as if these roles were performed in-house.

51. Where the DAB outsources roles, either externally to third parties or internally to other affiliated entities, the board must ensure that there is oversight and clear accountability for all outsourced roles as if these functions were performed internally and subject to the DAB's own standards on governance and internal controls. The board should also ensure that the service agreement includes terms on compliance with jurisdictional laws and regulations. Agreements should not prohibit cooperation with the Authority or the Authority's access to data and records in a timely manner.
52. Where the board has outsourced a role or is considering outsourcing a role, the board must assess the impact or potential impact on the DAB. The board must not outsource a role that is reasonably expected to adversely affect the DAB's ability to operate prudently. These considerations include where outsourcing is reasonably expected to:
  - a. Adversely affect the DAB's governance and risk management structures;
  - b. Unduly increase operational risk;
  - c. Affect the Authority's ability to effectively supervise and regulate the DAB; and
  - d. Adversely affect client protection.

## **IX. CONDUCT OF BUSINESS**

### **9.1 Integrity and ethics**

53. The DAB must conduct its business with integrity at all times, acting with due care, skill and diligence. It must deal honestly, professionally and fairly with all clients and seek to ensure that clients are not misled as to the products and services being provided and the duties and obligations of the DAB.

54. The DAB's directors, senior management and staff of the DAB must ensure that business is transacted in a manner that is free of self-dealing.

53:55. The directors, senior management and staff must not engage in any market manipulation or any other conduct directly or indirectly with the aim of to manipulating market prices of digital assets or any financial instrument. As part of protectingTo protect its clients and the jurisdiction's reputation, the DAB should have policies related to market manipulation and the appropriate use of its products and services. Where the DAB suspects or detects ~~that~~ abuse, such as spoofing or wash trading, the DAB

~~must~~should report such abuse to the Authority and take appropriate action, including account closure and termination of the business relationship with the offending party.

## **9.2 Conflicts of interest**

~~54.56.~~ Conflicts of interest naturally arise in the course of business and may be exploited on account of information asymmetry. The DAB must ensure it has policies and procedures to mitigate conflicts of interest to avoid harm to clients and stakeholders more widely, including policies and procedures regarding disclosing relevant information. ~~The~~In addition, the DAB must implement internal rules and procedures for dealing with conflicts of interest. Where conflicts of interest cannot be avoided, the DAB must keep adequate records of such conflicts of interest and take all reasonable steps to manage conflicts of interest and ~~to prevent such conflicts of interest from~~ damaging the interests of clients.

~~55.57.~~ This includes whether the conflict of interest arises directly in the course of its own role or, as relevant, between the DAB and its service providers or, e.g., between different classes of clients.

~~56.58.~~ The nature and relative market cap of the digital asset business industry inherently exposes it to arbitrage and market valuation manipulation. With information asymmetry and global connectivity, the DAB's board, officers or staff may at times be positioned to exploit opportunities at the expense of stakeholders. The conflicts of interest policies and procedures must also include measures that would prevent market manipulation such as insider trading, pump and dump or other schemes that may bring harm to clients.

### 9.3 Fair treatment of clients

59. The DAB must ensure that its business is conducted in such a way as to treat its clients fairly, both before the inception of the contractual arrangement and through to the point at which all obligations under a contract have been satisfied. The DAB must establish and implement policies and procedures to ensure that this occurs.

57-60. The policies should define acceptable and unacceptable behaviours by staff and outline consequences for non-adherence. The DAB should communicate policies and procedures to all relevant staff and provide appropriate training to ensure adherence by staff and any authorised sales representatives.

### 9.4 Vulnerable clients

61. The DAB shall take reasonable steps to identify vulnerable clients.

62. Broadly, a vulnerable client is a natural person who:

a. Has the capacity to make their own decisions but who, because of individual circumstances, may require assistance to do so (e.g., seniors, or visually impaired persons); or

b. Has limited capacity to make their own decisions, and who requires assistance to do so (e.g., minors);

63. The DAB shall take steps to provide appropriate facilities and access to information and services for the use of vulnerable clients, including consideration of the appropriateness of channels used to communicate information.<sup>1</sup>

64. The DAB shall establish and implement policies and procedures to accommodate and afford reasonable care to a client identified as vulnerable, or who discloses these needs to the DAB.

### 9.5 Product due diligence

58-65. Where a DAB seeks to introduce a new product or service, or materially modify an existing product or service, such a DAB shall be required to carry out appropriate Product Due Diligence (PDD) in relation to said product or service, and ensure that risks identified by the PDD have been appropriately weighted against the business risk appetite and mitigated prior to implementation of the new product.

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<sup>1</sup>Appropriate communication channels may include publication on the DAB's platform, website, mobile application, online chat and support functions, in the local media, social media, over the telephone or through the client's relationship manager. This list is by no means exhaustive, and the DAB should use appropriate channels based on the type of product and client in question.

~~59.66.~~ PDD shall be documented and include, at a minimum, an evaluation of the following:

- a. Product or service details;
- b. Product or service intended usage;
- c. Product or service risk profile;
- d. Targeted clients;
- e. Evaluation of risks to the DAB;
- f. Evaluation of risks to clients ([particularly vulnerable clients](#));
- g. Anti-money laundering and anti-terrorist financing implications;
- h. Marketing strategy;
- i. Fee model;
- j. Internal training;
- k. Client training;
- l. Potential conflicts of interest;
- m. Systems requirements;
- n. Cyber risk;
- o. Impact on staffing; and
- p. Legal [and regulatory](#) -implications.

~~60.67.~~ PDD shall be reviewed internally by the appropriate members of the executive team (e.g., chief compliance officer, chief risk officer) or a committee formed by the DAB with the appropriate delegated authority. The review should be appropriately documented and may be required by the Authority during normal supervision or following a material change to the business notification filed with the Authority under Section 22 of the Act.

~~61.68.~~ PDD should be reviewed periodically upon a frequency commensurate with the nature, scale, complexity and risk profile as determined by the DAB but not less than annually.

~~62.69.~~ Once a new product or service, or a material change to a product or service, is introduced, follow-ups are required and should be documented, inclusive of but not limited to:

- a. Monitoring of client complaints related to the product or service;
- b. Ongoing training; and

- c. Monitoring of compliance with any restrictions imposed on the product or service by the Authority or the DAB itself.

## **9.6 Advertising and promotions**

70. The DAB must promote products and services in a manner that is clear, fair and not misleading. The DAB must ensure that its advertisements (including social media campaigns, webinars, published articles and press releases):

- a. Do not contain a statement, promise, or forecast that is untrue, misleading, or deceptive;
- b. Are not designed in such a way as to distort or conceal any relevant subject material;
- c. Are clearly recognisable as advertisements;
- d. Use clear and easy-to-understand language; and
- e. Include a statement of the related risks.

~~63.~~71. The DAB shall ensure that information required for decision-making purposes is available where the relevant products and services are being offered, sold or marketed (i.e., where products are sold online, the information shall be clearly available and easily accessible on the DAB's website, app, etc.):

## **9.7 Sales practices**

72. The DAB must establish and ensure staff adherence to sales policies and procedures, that prohibit and prevent behaviour such as mis-selling, misrepresentations, aggressive sales tactics, and discrimination during the sales process.

## **9.8 Communications with clients**

73. The DAB must supply the client, or the potential client, with information that is adequate, up-to-date and material for decision-making purposes.

74. The DAB must not omit, diminish or obscure material information or warnings. The DAB must consider whether the omission of any relevant fact will result in the information being insufficient, unclear, or misleading.

75. The DAB must ensure that information is presented in a way that is likely to be understood by the client. The DAB must consider the impact of the content and presentation of information by:

- a. Positioning material information in a location such that it is obvious and apparent;

b. Simplifying language where possible; and

c. Considering the accessibility of the communication channel.

76. The DAB must be able to demonstrate that information is supplied to clients with reasonable timeliness, in a comprehensible form, and through the appropriate channel.

## **9.9 Disclosure of information**

77. The Digital Asset Business (Client Disclosure) Rules 2018 outline the disclosures that the DAB must make to clients to allow for their informed decision-making throughout the business relationship. In addition to this, the DAB's public platforms (including its website, mobile applications, social media, etc.) and materials provided to prospective clients must include details of the board, the chief and senior executive team, head office (and registered office, in case of Class T DABs –or if different); a description of its complaints procedure, and arrangements in case of business failure. The DAB must disclose to clients any material business changes that impact clients.

78. DABs are required to provide sufficient notice to their clients before effecting changes in: fees, charges and interest rates; material modifications to or discontinuation of products or services; material change to the terms and conditions of any services provided by the licensed undertaking, which includes any amendment to policies applicable to the client's account.

79. The Authority is cognisant that in certain instances, and due to the dynamic nature of this sector, this may not always be realistic (e.g., interest rates). Nevertheless, DABs are still expected to ensure that their clients are provided with sufficient notice to make informed decisions and allow them to choose to take action when material changes occur.

80. The DAB shall provide clients with clear instructions on reporting suspected fraud or other security breaches on their accounts. Contact information for such reporting shall be easy to locate on the DAB's website or other appropriate communication channels.

64.81. For transparency purposes, the DAB must also ensure that its status as a licensed undertaking is disclosed in all advertisements and correspondence. The following wording is suggested:

“Company X is licensed to conduct digital asset business by the Bermuda Monetary Authority.”

## **9.10 Suitability**

82. Where the DAB is responsible for providing advice or exercising discretion for or about clients, it must seek from the client such information about their circumstances and objectives as may be appropriate concerning the products and services to be provided.

83. In situations where advice is provided, the DAB must assess the relevant features of products and services against the client's information to determine the product's suitability before it is recommended, acquired, traded or otherwise transacted.

84. When providing advice, the DAB must present suitable options to the client to ascertain the most appropriate solution, given the client's needs and circumstances. The information provided should be sufficient to enable clients to understand the characteristics and any associated risks of the product, services or digital assets they are buying and help them understand how it may meet their requirements to make an informed decision.

85. The DAB must retain sufficient records to demonstrate that the advice provided was appropriate, taking into account the client's disclosed circumstances when the advice was provided.

### **9.11 Clear client responsibilities**

86. While clients maintain a level of accountability for their own choices and decisions, the DAB should appropriately remind clients of their responsibilities to:

- a. Read and understand the terms and conditions of products and services and seek independent financial and legal advice where appropriate;
- b. Disclose relevant information as it relates to the DAB's legal obligations, including but not limited to its AML and Anti-Terrorism Financing obligations, and inform the DAB of any changes to such required information;
- c. Disclose relevant information to assist the DAB in managing the relationship and ensuring the suitability of its products and services for the client;
- d. Verify statements for correctness; and to inform the DAB of any suspected errors; and
- a-e. Protect sensitive personal information used to access money, digital assets and accounts.

### **9.12 Client awareness**

87. Where appropriate to do so, having regard to the nature, scale and complexity of the business undertaken, the DAB shall develop resources to assist clients with developing the knowledge and skills necessary to:

- a. Understand risks regarding digital assets (including financial and technology risks);

- b. Make informed decisions and understand how their actions affect outcomes; and
- c. Know when to access independent legal and professional advice and assistance to help them make informed decisions.

88. The DAB should ensure that such resources are available through an appropriate communication channel for the benefit of its clients.

### **9.13 Client agreements**

89. To ensure clients are dealt with fairly and are informed, the DAB must disclose terms and conditions with each prospective client and keep a record of the terms of the agreement with each client, including evidence of the client's agreement to those terms.

65.90. That agreement should include, but not be limited to, the following provisions:

- a. Clear description of the services to be provided, fees to be charged, the manner in which how fees are expected to be paid and a confirmation of the minimum notice period that will be given when those fees change;
- b. General description of how, and by whom, requests for action are to be given;
- c. General description of any provisions for the termination of the agreement and the consequences of termination, including:
  - i. Provisions for a reasonable notice period;
  - ii. Information on the actions or inactions of the client which will lead to the termination of the business relationship by the DAB and the consequences of termination, including any termination or penalty fees which may be charged; and-
- e. General description of the rights and responsibilities of the DAB and the client.

91. The DAB shall not unduly, except as required by law, limit the client's ability to cancel or transfer a product or service to another provider on the client's reasonable notice and per the agreed terms.

92. Any changes to the terms and conditions during the relationship and throughout the product lifecycle shall be communicated to the client, using an appropriate communication channel and per the agreed terms.

### **9.14 Conducting business over the internet**

~~66.93.~~ A DAB, which uses the internet to communicate with and send informational material to clients and potential clients, must provide full and complete disclosures, regardless of the communication channel chosen so that must provide the same disclosure about their firm, products or services that would be provided in a paper-based medium so that clients can fully evaluate the risk and value of the services and products. The DAB may deliver the necessary disclosure documents and other information electronically where a client has given informed consent to this form of delivery.

~~67.94.~~ The DAB shall pay particular attention to ensure that all important information, including any disclosures required under the Digital Asset Business (Client Disclosure) Rules 2018, are prominently displayed and easily accessible by clients and potential clients.

~~68.95.~~ The DAB must ensure that its systems have sufficient operational integrity and that it has adequate personnel to handle internet communications, electronic transmission of orders and trading information to maintain appropriate service standards as disclosed to its clients or, if no specific service standard is disclosed to its clients, as can be reasonably expected from its clients.

### 9.15 Preservation of confidentiality

~~69.96.~~ Any obligation to ~~ob~~preserve the confidentiality of information communicated by clients must be adhered to by the DAB (including its shareholders, directors, officers, senior executives, staff, outsourced partners, etc.) unless the DAB is given relevant consent, is required by applicable law to disclose information, or provides information in accordance with the terms of the client constitutional documents. Accordingly, persons who have access to the DAB's confidential information should be advised in writing upon engagement. Further, the DAB should provide periodic reminders thereafter of confidentiality issues.

### 9.16 Client complaint handling

~~70.~~ The DAB must ensure that the client complaints are properly logged and dealt with in a timely manner. A record of the details of the complaint, the DAB's response and any action taken as a result should be maintained.

~~97.~~ The DAB must implement a complaints management framework that seeks to deal promptly with any client complaint. Where a client complaint identifies a valid error,

the DAB must seek to resolve the error within a reasonable timeframe relative to the nature of the issue.

98. The DAB must document complaint handling procedures that includes minimum processes for:

- a. Making a complaint;
- b. Handling complaints in a fair, timely and appropriate manner;
- c. Acknowledging receipt of complaints;
- d. Maintaining a complaint register containing details of complaints received and how they have been dealt with and resolved, including if no action was required by the DAB; and
- e. Analysis of the patterns of complaints and errors and sharing such information with the board or senior management, as appropriate.;

99. The client should not be burdened with unnecessary costs when seeking to resolve a complaint.

100. Information on the complaint handling procedure and the contact point for complaints must be made publicly accessible, (i.e., provided on the company website, and available upon request).

### ~~9.17~~ Closed accounts and inactive accounts

#### 9.17

101. When dealing with issues regarding closed and inactive accounts, the DAB shall have publicly available information, via an appropriate communication channel, of the criteria which will lead to an account being deemed inactive and its procedures in dealing with these matters.

102. Clients should be given reasonable notice, assistance, and an opportunity to rectify any shortcomings where the DAB proposes to close an account or deems it inactive, where allowable by law.

103. Where appropriate, funds shall be promptly returned to clients according to their instructions, when their account is closed or deactivated. The DAB shall have adequate procedures to facilitate the return of funds to clients as outlined in the terms and conditions governing the account and allowable by law.

~~74.~~104. Where appropriate and allowable by law, when a client wishes to close an account, the process should be as easy to complete as possible. -

## X. COOPERATION WITH REGULATORY AUTHORITIES

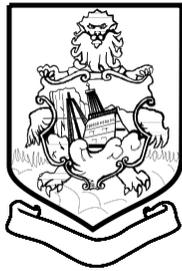
~~72.105.~~ The DAB is expected to deal openly and in a spirit of cooperation with the Authority and any other relevant regulatory authorities.

~~73.106.~~ The DAB should also ensure that any contracts or agreements ~~that~~ it enters ~~into~~ ~~does~~ not intentionally, or otherwise, frustrate the Authority's ability to carry out its supervisory or regulatory obligations ~~in relation to~~ concerning the DAB. These contracts or agreements should contain a provision that ensures that any outsourced vendors (and authorised agents) are aware of their role in assisting the DAB in meeting its legal and regulatory obligations under the Act and related legislation, and this Code.

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DRAFT

**APPENDIX II - DRAFT DIGITAL ASSET BUSINESS (CLIENT DISCLOSURE)  
AMENDMENT RULES 2022**



**BERMUDA**

**DIGITAL ASSET BUSINESS (CLIENT DISCLOSURE) AMENDMENT RULES  
2022**

**BR / 2022**

TABLE OF CONTENTS

- 1 Citation
- 2 Amends paragraph 3
- 3 Commencement

## **DIGITAL ASSET BUSINESS (CLIENT DISCLOSURE) AMENDMENT RULES 2022**

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The Bermuda Monetary Authority, in exercise of the powers conferred by section 7 of the Digital Asset Business Act 2018, makes the following Rules:

### **Citation**

1 These Rules may be cited as the Digital Asset Business (Client Disclosure) Amendment Rules 2022.

### **Amends paragraph 3**

2 Paragraph 3(3) of these Rules are amended by deleting sub-paragraph (g)(vi) and inserting a new sub-paragraph (g)(vi) as follows—

“(vi) the requirement for the client to receive, as soon as practicable, prior notice of—

- (A) changes in fees, charges and interest rates;
- (B) material modifications to or discontinuation of products or services; and
- (C) material change to the terms and conditions of any services provided by the licensed undertaking, which includes amendment to policies applicable to the client’s account;”.

### **Commencement**

3 These Rules come into operation on [DATE].

Made this    day of            2022

Mr. Donald Scott  
Chairman  
The Bermuda Monetary Authority