



8 February 2023

## **STAKEHOLDER LETTER**

### **Re: Consultation Paper: Conduct of Business Regulatory Regime: Digital Asset Business Act 2018: Code of Practice & Digital Asset Business (Client Disclosure) Amendment Rules 2023**

The Bermuda Monetary Authority (Authority or BMA) would like to thank stakeholders for their continued engagement as the Authority enhances its framework for supervising entities subject to the Digital Asset Business Act 2018 Code of Practice (CoP) and Client Disclosure Rules 2018 (CDR). The Authority appreciates the feedback received and is committed to ensuring Bermuda's regulatory regime remains effective and aligned with evolving international standards and market best practices, as well as providing appropriate protection to financial services customers.

The Authority sought feedback on a conduct of business supervisory regime through a Consultation Paper (CP) published in October 2022, proposing enhancements to the CoP and CDR by largely consolidating existing, and introducing new, conduct of business provisions.

### **RESPONSE TO INDUSTRY FEEDBACK**

The Authority received feedback from a few stakeholders and the responses to the key substantive comments received on the CoP are outlined below.

#### ***Code of Practice: Definition of Retail Client***

*Request:* Clarification was sought as to whether a definition of the term 'retail client' would be helpful to distinguish between 'retail' clients and 'institutional' clients and the level of protection afforded to them, respectively.

*Response:* The Authority recognises that licensed firms in this sector have different client profiles, with firms having differing numbers of 'retail' clients and some having none at all. Additionally, feedback from stakeholders who were consulted suggested that the vast majority of licensed Digital Asset Businesses (DAB) do not currently have a formal definition of 'retail' clients within their terms and conditions and that there is no industry-standard definition of who would constitute a 'retail' client.

The CoP already contains a proportionality principle that recognises the different business models of licensed DABs and their respective risk profiles. The Authority considers that this

allows licensed DABs, based on their client and product risk profiles, to have flexibility in how to apply the conduct of business provisions and provide the appropriate level of protection for clients based on their individual characteristics.

*Request:* Related to the above, one respondent provided the U.S. Securities and Exchange Commission's definition of a retail investor: "*Retail Investor - an investor with an annual salary less than \$200k, or a net worth <\$1m. A couple can invest jointly; however, the annual salary threshold increases to \$300k, while the net worth condition does not change. These thresholds are used to identify a threshold of investor protection afforded to the investor.*"

*Response:* The definition suggested above applies to investors in a specific scenario (an 'accredited investor'). There are many different business models within the DAB sector and to use a definition that only takes net worth into account, as suggested above, may not adequately address information asymmetries, product knowledge and other consumer protection concerns. Rather, as explained above, the Authority believes that the use of the existing 'proportionality' principle is sufficient for firms to decide how they should meet their conduct of business obligations, referencing their specific client and product risk profile.

The Authority will continue to work with stakeholders during the adoption of the conduct of business framework. Should it become necessary in the future to legislate a definition of 'retail' customer appropriate to the DAB sector in Bermuda, then further consultation will be held to ensure protection for those most at risk of harm in a way that does not create unintended consequences for the industry or administratively burden DABs.

*Request:* Vulnerable clients - a respondent stated that "*this section only defines that a natural client can be seen as a vulnerable client. This, however, could also be defined to include clients that are legal persons, especially if those legal persons are smaller entities, like SMEs, or alternatively have the scope enlarged to include vulnerable natural persons working for a DAB that falls within the specified scope.*"

*Response:* The Authority has chosen to focus on vulnerable clients who are natural persons at this time. Understanding that there may be others who could be considered vulnerable and who may benefit from additional protections, this is something that the Authority may explore in the future should it become necessary to do so.

*Request:* A respondent suggested that in relation to Section 90.b. "*consider adding a requirement that the parties are to be clearly stated, who is represented, as paragraph b is vague in this regard. Consider inclusion of who is allowed to receive requests for action and who is allowed to render advice to clients, are they duly authorised to do so and on behalf of the DAB.*"

*Response:* The Authority will consider whether further amendments to Section 9.13 - Client Agreements will provide additional clarity.

### ***Next Steps***

By taking an outcomes-based approach to designing the CoP, the Authority's goal is to hold DABs accountable for the impact of their actions on clients and potential clients while removing the need to be overly prescriptive on processes, which may differ necessarily

depending on the DAB's nature of business and type of client involved. If DABs remain unclear regarding their responsibilities pursuant to the CoP and CDR once issued, they are encouraged to reach out to their usual BMA contact.

The Authority intends to finalise the CoP and make the rule changes to the CDR based on the feedback received. A suitable transition period will be recommended and communicated to all DABs to allow them to comply with the new provisions.

The Authority would like to thank stakeholders for their feedback and remains committed to ensuring appropriate customer protection by working closely with financial institutions and other interested parties. Stakeholders who would like further clarification or additional information on these matters should contact the Authority directly at [conduct@bma.bm](mailto:conduct@bma.bm).