



Jersey
blockchain and
cryptocurrency
regulation 2020,
second edition

CAREY OLSEN

Government attitude and definition

Jersey continues to embrace fintech including blockchain and distributed ledger technology (“DLT”) as a pioneer in fintech regulation. Jersey enjoys a sophisticated legal, regulatory and technological infrastructure, supporting development and innovation in fintech, including:

- cryptocurrency exchanges and security token exchanges;
- security token and non-security token issuances;
- electronic identification;
- online payment solutions; and
- fintech funds and other vehicles.

Jersey recognised cryptocurrencies as a separate asset class long before the “ICO Craze” of 2017, when the island’s regulator, the Jersey Financial Services Commission (the “JFSC”) licensed the world’s first Bitcoin-focused, regulated fund (GABI Plc). From that point onwards, the island has seen a surge of interest in exchange vehicles, token issuers and fintech funds choosing Jersey; including the world’s largest investment fund (The SoftBank “Vision Fund” which raised \$97bn over two years). Both GABI and Softbank were advised by Carey Olsen Jersey LLP (“Carey Olsen”).

The JFSC is a member of the Global Fintech Innovation Network and participates in the cross-border testing pilot.

Jersey has an exceptional pool of blockchain expertise, developed from the JFSC’s forward-thinking attitude combined with Jersey’s flexible range of corporate vehicles and favourable tax regime.

Examples of structures that have recently used Jersey (advised in each case by Carey Olsen) include:

- CoinShares Fund I, a venture capital fund investing in Ether (a cryptocurrency used as a payment on the Ethereum blockchain platform) and Initial Coin Offerings (“ICOs”); and
- Binance, the world’s largest cryptocurrency exchange, which has established a Jersey exchange platform.

Jersey strives to promote fintech development by supporting local fintech talent. Digital Jersey, a government-backed economic development agency and industry association dedicated to the growth of the digital sector, aims to do this.

Blockchain and cryptocurrency/digital asset regulation

To date, Jersey has not needed to introduce blockchain-specific legislation because the prevalent fintech matters (set out below) have not necessitated it. These can be grouped as follows:

1. Initial Coin Offerings; (“ICOs”);¹
2. Security Token Offerings (“STOs”);
3. non-security token issuances;
4. Cryptocurrency Exchanges (so-called Virtual “Currency Exchanges”);
5. Security Token Exchanges;
6. arrangements clearly falling within the existing regulatory framework such as custody; and
7. Jersey funds investing in digital assets.

The regulatory treatment of each of these is set out below:

ICOs

Jersey has seen a large number of ICOs. This is in part because the JFSC recognised that ICOs with proper substance and backed by a credible promoter should be nurtured.

ICOs involve the issuance of a coin. Consideration must be given as to whether such coin/token/asset constitutes a “security” under Jersey law, and therefore whether it falls within the existing regime regulating securities and their issuances. To assist with this analysis, the JFSC issued guidance on the interpretation of the various categories of digital assets and their corresponding treatment, entitled **Guidance Note on the Application Process for Issuers of Initial Coin Offerings** (the “JFSC Guidance”).²

In short, the JFSC Guidance outlines the three key areas of the JFSC’s regulatory focus, being:

- the economic function and purpose of the digital assets to be issued;
- their underlying purpose; and
- whether they are tradeable and transferable.

Against this backdrop, Carey Olsen advised on the launch of Jersey’s first ICO in December 2017, ARC Reserve Currency. ARC is an asset-backed “stablecoin” cryptocurrency, which is designed to act like a currency without the volatility spikes one sees in other cryptocurrencies such as Bitcoin. Carey Olsen worked closely with the JFSC to ensure that the ARC coin launched ahead of time and with a degree of regulatory scrutiny that should give prospective purchasers a degree of comfort not available in other jurisdictions. Subsequently, Carey Olsen built on its ICO expertise by advising on AX1 token, an ICO designed to raise capital for investment in a cryptocurrency mining operation based in the UK.

In both instances, the JFSC adopted a purposive and pragmatic approach to approving the ICOs, focusing on consumer protection and anti-money laundering whilst recognising that ICO promoters use a Jersey-incorporated issuer due to Jersey's reputation as a well-regulated and reputable jurisdiction.

In order to give prospective ICO investors a degree of disclosure and comfort that may not be available in many other jurisdictions, the JFSC sets out certain requirements on an ICO issuer.

The ICO issuer is required to:

- be a Jersey incorporated company;
- receive the JFSC's consent before undertaking any form of activity;
- comply with the JFSC's Sound Business Practice Policy (see below);
- apply relevant AML/CFT requirements to either purchase tokens from or sell tokens back to the issuer;
- appoint a Jersey-licensed administrator;
- appoint and maintain a Jersey-resident director on the board;
- be subject to an ongoing annual audit requirement;
- have procedures and processes in place to (i) mitigate and manage the risk of retail investors investing inappropriately in the ICO, and (ii) ensure retail investors understand the risks involved;
- prepare an information memorandum which complies with certain content requirements required under Jersey company law; and
- ensure that any marketing material is clear, fair and not misleading, and include in any such materials certain prescribed consumer warnings.

Security Token Offerings

Whilst there is no universally recognised terminology for the classification of tokens, as mentioned above, the JFSC Guidance distinguishes between digital assets for Jersey purposes by considering whether they are a "security" or not. This is particularly important for the purposes of Jersey law under the Island's statutory instrument governing the raising of capital, the Control of Borrowing (Jersey) Order 1958 ("COBO").

Before a security token issuer can undertake any activity, it requires consent from the JFSC under COBO and the type of COBO consent granted by the JFSC will depend on whether the token is categorised as a "security" under COBO.

The JFSC Guidance stipulates that a token which has one or more of the following characteristics will be regarded by the JFSC as a "security":

- a right to participate in the profits/earnings of the issuer or a related entity;
- a claim on the issuer or a related party's assets;
- a general commitment from the issuer to redeem tokens in the future;
- a right to participate in the operation or management of the issuer or a related party; and
- an expectation of a return on the amount paid for the tokens.

If the issuance constitutes a security and is to be an STO, the usual Jersey considerations for the issuance of a security apply including COBO, the Companies (General Provisions) (Jersey) Order 2002 regarding the issuance of a prospectus and the Companies (Jersey) Law 1991 and activities related to the securities, including dealing under the Financial Services (Jersey) Law 1998 (the "FSJL").

Non-security token issuances

Coin and token issuances that do not constitute "securities" do not fall under the ambit of the FSJL.

The JFSC Guidance contains a helpful statement that the JFSC will not treat a utility token (i.e. a token conferring a usage right and with no economic or voting rights) as a "security" token solely by reason of the fact that it might be traded in the secondary market (e.g. listed on an exchange).

The application for a non-security token issuer's COBO consent is to be accompanied by analysis prepared by the issuer's legal advisers, outlining:

- the proposed activity, including relevant timelines;
- details of the issuer;
- rationale for the proposed activity, amount to be raised and use of proceeds;
- a summary of the features of the tokens;
- a summary of the token purchase and redemption processes;
- the service providers to the issuer;
- the relationship between issuers and holders of the tokens;
- the management of underlying assets and security rights over such assets (if any) for holders of the tokens;
- how the activity will be wound up/dissolved and assets (if any) distributed to the holders of the tokens; and
- a Jersey legal and regulatory analysis, including consideration of relevant legislation or other regulatory laws.

Following grant of the COBO consent, the issuer must seek the prior consent of the JFSC to any material change to the matters contained in the application.

Virtual Currency Exchanges (“VCEs”)

At an early stage, the JFSC saw an increase in the volume and value of trading in cryptocurrencies as they were exchanged into fiat currencies and vice versa. In 2016 and in recognition of the regulatory gap, the JFSC brought the provision of VCE services in Jersey under Jersey’s regulatory umbrella by extending the scope of existing laws and regulations.

As a result, the Proceeds of Crime (Jersey) Law 2009 (“POCJL”) requires VCEs to comply with the Island’s laws, regulations, policies and procedures aimed at preventing and detecting money laundering and terrorist financing. POCJL also categorises VCEs as “supervised business” and consequently introduces a requirement for VCEs to register with, and be subject to, the supervision of the JFSC. The JFSC also allows VCEs with turnover of less than £150,000 per calendar year to test VCE delivery mechanisms in a live environment without the full registration requirements and associated costs. As such, Jersey’s VCE regulation balances the need to provide robust regulation with a desire to foster the development of the Island’s burgeoning crypto-credentials.

Security Token Exchanges

Jersey has recently seen an influx of potential security token exchange platforms and Carey Olsen is working closely with credible promoters to advise on these matters. The JFSC have indicated that security token exchange businesses will be required to be regulated under the FSJL to undertake “investment business” (the “IB Licence”).

A standard application for an IB Licence will take approximately eight weeks. An application for a digital assets-related matter may take a little longer. A full regulatory application to the JFSC will be required and will include the following documents:

- a regulatory application form;
- a business plan; and
- a business risk assessment.

In terms of regulatory capital requirements, the main requirement to be aware of is that an exchange platform will be required to maintain at all times:

- a net liquid assets position of 130% of its projected quarterly expenditure;
- a minimum of £25,000 paid-up share capital; and
- a minimum net assets position of £25,000 at all times.

In addition, a Jersey security token exchange must be audited and the composition of the board must comply with the Jersey regulatory and economic substance requirements, being:

- there must be a minimum of two Jersey resident directors;
- the board must meet with adequate frequency having regard to the amount of decision making being undertaken;
- at meetings there must be a quorum of directors physically present in Jersey; and
- the directors of the company must have the necessary knowledge and expertise to discharge their duties (this is assessed on a whole-board basis).

Once an IB Licence has been obtained, the holder will need to observe the provisions of the JFSC’s Code of Practice for Investment Business.

There are locally regulated administrators in Jersey who can assist by providing “incubation” services to entities and groups that are new to Jersey.

There is no requirement to have electronic clearing and settlement or for clearing of security tokens to be carried out by a clearing house or central depository.

Applications under the existing regulatory framework

JFSC’s Sound Business Practice Policy

The JFSC will treat transactions with digital assets and cryptocurrencies as a “sensitive activity” under the JFSC’s Sound Business Practice Policy.

The practical consequence of this is that certain AML/CFT obligations are imposed on the issuer, such as to carry out checks on: (i) the purchasers of the tokens who purchase coins directly from the issuer; and (ii) the holders of tokens issued by the issuer in the event they are sold back to the issuer. In such circumstances, the issuer will be required to obtain information to: (a) establish and obtain evidence to verify identity; and (b) establish and, depending on the level of risk, obtain evidence to verify the source of funds and source of wealth.

Custody services and arrangements for holding digital assets

For VCEs and security token exchanges, services related to the custody of the digital assets need to be considered. There are two models: (i) custody services provided by the exchange itself (or a related entity) to investors and exchange users; or (ii) custody services outsourced to a third party custody provider to be provided to investors and exchange users.

In both models, where digital assets will be stored offline or where the investor or exchange user is not provided with the keys to access the digital asset, the investor/exchange user will no longer have control over the digital assets they have

invested in. In this way, it is likely that the relevant custodian entity will be providing trustee services and will need to be regulated for “trust company business” under the FSJL. However, where the storage of digital assets is incidental or ancillary to the main purpose of the entity and where there was no separate remuneration, an exemption may apply. Early advice should be sought on this point, and this is something Carey Olsen has experience of advising on.

Jersey Private Funds and Jersey Expert Funds

Jersey fund structures are used in the digital assets space. Such entities will be required to comply with the existing regulatory framework, as set out in brief below.

Jersey regulatory classifications provide a “safe harbour” with three-day approval from the JFSC for the majority of non-retail funds.

Jersey Private Funds are fast and flexible to set up, with minimal requirements for funds with fewer investors (only up to 50 investors). Jersey Private Funds are not regulated and must not be listed on a stock exchange. There is no limit on fund size, no investment or borrowing restrictions, they can be open or closed for redemptions by investors and are open to “professional” investors and those investing £250,000 or more. There is a “Fast track” approval by self-certification by the fund administrator.

Expert Funds are attractive for non-retail schemes aimed at “Expert Investors”. Expert Funds can be established quickly and cost-effectively and must comply with the Jersey Expert Fund Guide (the EF Guide).

The definition of “Expert Investor” is crucial. An investor must fall within any one of the 10 categories, which include a person or entity: in the business of buying or selling investments; with a net worth of more than US \$1m, excluding principal place of residence; with at least US \$1m available for investment; connected with the fund or a fund service provider (there is a flexible approach to carried-interest arrangements); or (the simplest category) making an investment or commitment of US \$100,000 or more (or currency equivalent).

The investment manager/adviser must be: established in an OECD member or any other state or jurisdiction with which the JFSC has entered into a Memorandum of Understanding or equivalent; regulated in its home jurisdiction (or, if not required to be, approved by the JFSC, which usually occurs on an expedited basis); without convictions or disciplinary sanctions; solvent; and experienced in using similar investment strategies to those adopted by the Expert Fund. If the investment manager/adviser does not meet these requirements, it may approach the JFSC on a case-by-case basis. Of course, if

permission is granted then, absent any material change, the investment manager/adviser will not need specific approval to establish further Expert Funds. An investment manager/adviser is not required for certain self-managed funds, such as direct real estate or feeder funds.

All Jersey funds (other than notification only funds) are eligible to be marketed into the European Union and European Economic Area (“EU/EEA”) in accordance with the Alternative Investment Fund Managers Directive (“AIFMD”) through national private placement regimes and (once available) through the passporting regime. Jersey funds with a Jersey manager which are not actively marketed into the EU/EEA fall outside the scope of AIFMD.

Taxation

Jersey is a low-tax jurisdiction.

There are currently no laws in Jersey specifically regulating the taxation of cryptocurrencies or digital assets. Accordingly, it is likely that such assets will be taxed in accordance with general Jersey taxation principles and provisions.

Promotion and testing

Jersey promotes and tests fintech firms’ products and service in a number of ways.

In terms of testing products and services, the JFSC has proven itself to be a pro-active and forward-thinking regulator in becoming a member of the Global Fintech Innovation Network (a group of international regulators and observers committed to supporting innovative products and services) and participating in the cross-border testing pilot which launched in January 2019 offering firms the opportunity to test their products and services in multiple jurisdictions.³

Jersey also operates a sandbox run through Digital Jersey, supporting local fintech firms and fintech firms seeking to relocate to Jersey.⁴

In terms of promoting fintech and thought-leading in Jersey, the Digital Assets Working Group (the “DAWG”) works hard to raise awareness and interest in Jersey. Combining representatives of the States of Jersey, representatives of the JFSC and other interest groups on the Island, the DAWG is a group of individuals knowledgeable in the fintech space promoting digital assets and blockchain technologies in Jersey. Carey Olsen is a founder member of the DAWG and is an active participant and contributor.

Mining

Mining cryptocurrencies is not covered by any specific piece of legislation or regulation in Jersey. However, depending on the manner in which mining activities are conducted, it may fall within the existing regulatory framework for funds (mentioned above).

Border and reporting restrictions

At present, there are no border restrictions in place on declaring cryptocurrency holdings. Equally, there are currently no specific reporting requirements triggered for cryptocurrency payments.

The future of blockchain and DLT in Jersey

As a nascent technology, international industry practices around blockchain and DLT are still evolving and its applications and use cases (including outside the finance industry) being asserted. To maintain its place as a respected well-regulated international finance centre, Jersey is cognisant, and encouraging, of the advantages blockchain and DLT brings to Jersey's finance industry.⁵

As a long established well regulated international finance centre, Jersey boasts a host of industry experience and local expertise in Jersey,⁶ making Jersey an ideal jurisdiction to launch new blockchain and DLT initiatives.

Leveraging this existing expertise and the low-tax environment, we expect to see Jersey and Jersey vehicles continue to be used in both established areas of finance as they embrace blockchain solutions (such as proptech, online settlement solutions e-ID and regtech, etc.) and new areas of finance and other sectors as blockchain and DLT use cases are established.

The JFSC's considered and measured approach to fintech regulation to date should equip Jersey to be a leading blockchain and DLT jurisdiction of the future by ensuring regulation in Jersey remains appropriate and commensurate to the product or service in question.

We would be happy to discuss any blockchain or DLT initiatives backed by persons of substance.

Please do contact us using the details below.

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Christopher spearheads Carey Olsen's crypto practice and digital assets team, advising on the launch in 2017 of Coinshares Fund I (a venture cap fund investing in crypto assets) and ARC Reserve Currency, Jersey's first initial coin offering or "ICO". Christopher was instrumental in the launch of the Jersey platform for Binance, the world's largest cryptocurrency exchange. Christopher also advises on all aspects of fund and corporate transactions, including the legal and regulatory aspects of fund launches, and joint ventures. He also has considerable experience in dealing with the Jersey Financial Services Commission in navigating investment vehicles through the Jersey regulatory approval process.

Christopher has broad experience of both general international corporate and funds work with particular expertise in private equity and hedge funds, having spent 10 years in the City at Ashurst, RAB Capital plc and most recently at SJ Berwin.



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Emma is a senior associate in the Carey Olsen Jersey digital assets team and has advised in relation to a number of blockchain- and digital asset-related matters including in relation to: the establishment of virtual currency exchanges and security token exchanges; the use of Jersey vehicles for token issuances; and digital company administration in Jersey. Emma has a keen interest in blockchain and the adoption of fintech solutions in Jersey. Emma has a background in international corporate and finance transactions and her expertise includes the raising of finance through the issuance and listing of Eurobonds and other securities on The International Stock Exchange and looks forward to listing digital representations of securities in the coming years.

Emma is an advocate of the Royal Court of Jersey. She is a barrister of England and Wales (non-practising) and an English solicitor. She was educated at King's College, London University. Emma joined Carey Olsen in 2005. In 2016, she was seconded to The Royal Bank of Scotland International Limited.



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Holly is an associate in Carey Olsen's corporate department. She is a member of the digital assets team and has assisted with various matters related to cryptocurrencies/digital assets and blockchain, including the launch of Binance's Jersey exchange platform. Holly also advises on the raising of finance by issuers and the listing of Eurobonds and other securities on The International Stock Exchange ("TISE") (formerly the Channel Islands Securities Exchange), having completed a secondment at TISE. She is now excited to advise on the listing of digital representations of securities.

Holly is an advocate of the Royal Court of Jersey. She was educated at King's College, London University. Holly joined Carey Olsen in 2013.

Endnotes

1. In the fintech space, the ICO terminology has now largely been superseded by reference to security and non-security tokens, a reflection of the evolving regulatory backdrop. We retain reference to ICOs in this article because we, Carey Olsen, have advised in relation to a number of ICOs and that was the terminology used at that time. The settled approach now is to determine whether a coin or token or other digital asset issued constitutes a security or not and therefore whether it is a "security token" or not. We have addressed STOs and non-security token issuances separately.
2. It has been confirmed that this JFSC Guidance has a wider application and can be used to inform how digital assets and cryptocurrencies more generally will be treated. Available at jerseyfsc.org/media/2003/2018-07-12_jfsc-issues-ico-guidance-note.pdf.
3. The window for applications to participate in the January 2019 pilot has now closed.
4. See: www.digital.je.
5. Such as: (i) real time settlement; and (ii) greater transparency as to origination or provenance of the asset in question. For example, as Jersey currently has no restrictions or requirements around financial settlement, Jersey is an ideal jurisdiction from which to launch securities and cryptocurrency exchanges.
6. Including in banking, international payments, compliance, funds, capital markets, real estate and company administration.

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PLEASE NOTE

Carey Olsen Jersey LLP is registered as a limited liability partnership in Jersey with registered number 80.

This guide is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such. © Carey Olsen Jersey LLP 2020

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