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# New regulations for virtual assets and innovative finance in Guernsey

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The Guernsey Financial Services Commission published its final draft of the **Lending, Credit and Finance Rules and Guidance, 2023** (the "**New Rules**") on Thursday 19 January 2023. These support the **Lending, Credit and Finance (Bailiwick of Guernsey) Law, 2022** (the "**Law**").

We explained at the time that there are now four license categories and that more Guernsey firms may be covered by the New Rules than might have been expected – but what does this all mean?

This article concerns Virtual Asset Service Providers ("**VASP**s"), a term that includes cryptocurrency businesses; crowdfunding platforms; and peer-to-peer finance platforms and marketplaces.

Readers should be warned that the GFSC has taken a cautious approach to these innovative and yet unproven finance platforms, with consumer protection in mind.

If your business (or proposed business) is in any way involved, this is important information that you will need to be aware of prior to 1 July 2023.

## Platform and intermediation businesses

Any platform that intends to link potential lenders or investors with potential borrowers or entities seeking investment in a "peer-to-peer" (sometimes referred to in the UK as "innovative finance") model will be regulated under Part IV of the Law and the New Rules.

These include:

- operating a peer-to-peer credit or lending marketplace;
- providing alternative non-bank financing or intermediation; or
- operating a crowdfunding platform (other than a charity "just giving" style platform).

The GFSC has the power under the Law to add more activities to this list by regulation.

## How do I establish a platform and intermedian business?

Platforms will need a Part IV licence as standard. However, they may also need a Part II or Part III FFB licence, depending on how they plan to run their activities.

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If you are considering establishing a peer-to-peer lending, crowdfunding or other alternative finance business in Guernsey, consider speaking to our Corporate Advisory team to discuss potential requirements for your business.

## Benefits and restrictions of Part IV licenses

Innovative finance is still a new concept that has only been possible thanks to the maturity of the internet and the New Rules reflect a suitably flexible approach, as it remains to be seen what new variations of these platforms might appear.

There are two considerations that are unique to Part IV licences: the first comes from the nature of the platform as an intermediary between parties who would otherwise be unregulated, while the second is a restriction put in place to protect customers.

### Lenders themselves may not need their own licence

Although the wording of the Law is somewhat unclear, and the GFSC retains the power to direct otherwise, the definitions of each activity in sections 28(2), 29(2) and 30(2) of the Law state that "*the person who is the operator of the platform shall be deemed to be the person providing, offering to provide or holding themselves out as being willing to provide the service or activity in question*".

If this is read with the Part II licensing scheme, this means that a peer-to-peer lending intermediation business licenced under Part IV and Part II itself may enable unlicensed lenders and non-bank providers of home finance to continue to lend money to their intended borrowers provided that they use the platform as an intermediary.

### Maximum net worth criteria

Unlike in the UK, where exemptions exist for sophisticated and high net worth investors, the New Rules restrict platforms from allowing investors to contribute more than 15% of their net assets (excluding their home) to these kinds of product.

Businesses operating these kinds of platforms shall be required to assess the net worth and financial assets of lenders or investors prior to allowing them to use the platform to lend or make their investment. However, the guidance note in the New Rules explains that businesses may rely on self-certification by their customers.

## Virtual Asset Service Providers and "VASP" businesses

### What actually is a VASP?

"Virtual assets" are defined in section 17(4) of the Law as being digital representations of value "*that can be digitally traded, or transferred, and can be used for payment or investment purposes*". However, these do not include digital representations of fiat currencies (i.e. normal cash) or general securities and derivatives.

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Arguably, this definition does not include non-fungible tokens, like the infamous crypto punks or bored ape yacht club; but it *would* capture a token backed by a physical asset if that was used for investment purposes.

Section 17 of the Law prevents firms from taking the following actions with respect to virtual assets without being a VASP and operating under a licence:

- Exchanging between virtual assets and fiat currencies
- Exchanging between one or more forms of virtual assets
- Transfer of virtual assets
- Safe-keeping and administration of virtual assets themselves, or instruments enabling control over virtual assets
- Participating in or providing financial services to offering virtual assets, such as book-building and underwriting "initial coin offerings" and market-making
- Any other service or activity or class or description in respect of virtual assets specified by regulation

## What do VASPS need to do?

VASPs who wish to do any of the above activities need to apply for a Part III VASP licence. They will be bound to the same standards as Financial Firm Businesses, as well as the following additional requirements:

**Environmental declarations**

VASPs must publish information annually about the environmental impact of consensus mechanisms of each virtual asset with which they deal. Where the mechanism involves consumption of resources, such as electrical power, the carbon emissions, direct and indirect, of the VASP's activities, gross and net after mitigation, must be declared and made readily accessible to the public.

This is going to be nearly impossible for a VASP to estimate, since most virtual assets are decentralised and there is no real way to make this assessment. The University of Cambridge Judge Business School estimates that the emissions of Bitcoin, the most widely available virtual asset and therefore the focus of most studies, comes to 0.11% of global carbon emissions, but states that its estimates are "best guess" and there seems to be no agreed position between this and other reports. It is not clear yet whose figures the GFSC will accept as a reliable source for any reports, and this will be a challenge for any VASP.

**Safekeeping of virtual assets**

If a VASP is to take custody of a customers' virtual assets, these all need recording in the customer's name or their nominee's name. It cannot use these assets for lending or for its own account unless it has written consent from the customer and, in the case of lending, a written agreement specific to the loan from that customer.

**Restrictions on business**

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The GFSC has placed a blanket ban on the licensing of any VASPs intending to do business with retail customers. Dealing to individuals may be considered through an intermediary, but the GFSC has expressed an intention to deal with Part III VASP applications on a daily basis, and reserves the right to add further restrictions based on the business model. This may well prevent effective development in this area, as the proposed fees for 2023 were £150,000 for VASPs operating as an exchange and £25,000 otherwise.

## What happens if we ignore the New Rules?

Fines may be issued, and in some cases a fine and up to two years imprisonment, for persons who contravene the Law and by extension the New Rules. These punishments may be handed down to directors and officers of organisations as well as to companies and partnerships themselves.

*If you think that your firm might be impacted by the New Rules, we are happy to help. Please get in touch with our Guernsey Corporate Advisory team to discuss potential impacts to your business.*

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