CHAMBER OF DIGITAL COMMERCE

The Chamber of Digital Commerce is the world’s largest trade association representing the blockchain industry. Our mission is to promote the acceptance and use of digital assets and blockchain technology. Through education, advocacy, and working closely with policymakers, regulatory agencies, and industry, our goal is to develop a pro-growth legal environment that fosters innovation, jobs, and investment.

TOKEN ALLIANCE

The Token Alliance is an industry-led initiative of the Chamber of Digital Commerce, developed to be a key resource for the emerging industry surrounding the generation and distribution of tokens using blockchain technology. Comprised of more than 400 industry participants, the Alliance includes blockchain and token and legal experts, technologists, economists, former regulators, and practitioners from around the globe. The Token Alliance develops community-driven guidelines for the responsible development of tokens.

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II. PART 1: REGULATORY OVERVIEW OF DIGITAL TOKEN MARKETS

SECTION 5: GIBRALTAR

I. INTRODUCTION

On 1st January 2018, Her Majesty’s Government of Gibraltar (“HMGOG”) brought into effect a new distributed ledger technology (“DLT”) regulatory framework (“DLT Framework”) defined on a principles basis with the ability to be applied proportionately to the business in question, providing businesses with the regulatory certainty that has been pursued by so many for so long. The intention is not to exclude certain activity from the existing regulatory framework but, rather, to build out a specific framework for businesses that use DLT to “store or transmit value belonging to others” by way of business, and that may not have been subject to regulation under another existing framework in Gibraltar. Similarly, the purpose is to build a framework that can continue to evolve and allow for the Gibraltar Financial Services Commission (“GFSC”) to set appropriate and proportionate conditions or restrictions.

The DLT Framework includes nine principles applied to DLT firms operating in Gibraltar. The response to this approach has been global and truly significant with a large number of well-known businesses applying for licenses under the regulatory regime. Those who know nothing about Gibraltar may be surprised, but those who know the history of a small jurisdiction being able to adapt and evolve to attract the right opportunities at the right level, with the speed and flexibility needed to accomplish such goals, will not be surprised at all.

In addition to the above, the GFSC released a public statement on 22nd September 2017 noting the increasing use of digital tokens based on DLT as a means of raising finance, especially by early stage start-ups. The GFSC also noted that these new ventures were highly speculative and risky, that early-
stage financing is often best undertaken by experienced investors, and set out matters that ought to
be considered by anyone thinking of investing in digital tokens. In addition, the statement set out an
intention to regulate the “promotion and sale of [digital] tokens.” HMGOG has publicly announced its
intention to introduce regulations relating to, amongst other things, the promotion and sale of digital
tokens in and from Gibraltar and set out its proposals in a document issued on 12th February 2018 (the

II. THE GIBRALTAR REGULATORY FRAMEWORK

Digital tokens vary widely in design and purpose. In some cases, they may represent securities, such as
shares in a company, and their generation and distribution are already covered by existing securities
legislation in Gibraltar such as the Prospectuses Act 2005. The classification as a security triggers
various consequences, in particular regulatory consequences. The requirement to issue a prospectus
when offering securities publicly is only one example of such a requirement. A distinction must be drawn
between the concept of a security on the one hand and a financial instrument on the other, with the
latter being the broader term. “Securities” are one of several sub-categories of financial instruments.
Regulatory requirements may therefore also arise for non-securities that are classified as financial
instruments. This includes the requirements arising under the Markets in Financial Instruments Directive
(MiFID) II, transposed into Gibraltar law through the Financial Services (Markets in Financial Instruments)
Act 2018,5 which, in addition to applying to businesses providing certain investment services or
engagement in certain activities with clients in relation to financial instruments, also defines “financial
instruments” in a wide form, including forms of commodity derivative contracts and arrangements that
may apply to any asset or right of a fungible nature (under certain conditions).

As a British Territory and current member of the European Union (“E.U.”), the applicability of other
existing frameworks would also need to be considered in the digital token context - electronic money
issuance (“E-money”) being an example. Even within the E.U., there are differing interpretations of the
applicability of different regimes or rules. In the context of digital tokens, the tokens must represent a
claim on the issuer in order to fall within the definition of “electronic money.” This might be the case for
some digital tokens; however, utility tokens, as a rule, are usually not issued for the purpose of making
payment transactions. This may not be the case for digital tokens that serve a cryptocurrency use; but
even then, these tokens usually tend not to represent monetary value. It is characteristic for E-Money that
it represents fiat and stores its value, backed by a claim on the token issuer for redemption against fiat.
Conversely, digital tokens issued at par value against fiat and furnished with the promise of the token

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2 The terms used in this Section are exclusive to the enacted and proposed legislation of Gibraltar.
issuer to be redeemed in exchange for fiat, and therefore being accepted as means of payment by third parties, would qualify as E-Money.

Similarly, collective investment scheme (“CIS”) law such as the Financial Services (Collective Investment Schemes) Act 2011 is another relevant legal consideration. A collective investment scheme is described as: “any arrangement with respect to property, the purpose or effect of which is to enable persons taking part in the arrangement, whether by becoming owners of the property or any part of it or otherwise, to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.” There can be many scenarios where digital tokens may not be defined as “securities” but may still be deemed to represent units in a collective investment scheme. In this case, a number of points would need to be considered, including the relevant exemptions and carve outs that may, under certain circumstances, also be relevant.

In addition to the above, the definition of an alternative investment fund (“AIF”) under the Financial Services (Alternative Investment Fund Managers) Regulations 2013, which transposes the E.U. Directive relating to alternative investment funds, needs to be considered. An AIF is deemed to be any collective investment undertaking that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. If the arrangement is considered to form an AIF, or a token is deemed to represent a unit in an AIF, there are multiple considerations that become relevant, both in terms of the sale, promotion, and management of that scheme as well as the depositary arrangements for those units.

In many cases, digital tokens should not normally risk being a CIS. More often, however, digital tokens serve some cryptocurrency or functional use that is unregulated, such as the advance sale of products that entitle holders to access future networks or consume future services, or virtual currency, serving principally as a medium of exchange within an ecosystem (or marketplace) of consumers and service providers. However, entities issuing such types of digital tokens may still have to comply with classic consumer protection law, depending on the design of the digital token.

A. GIBRALTAR CONTRACT LAW

The law of contract in Gibraltar is similar to the law in England and Wales. English common law applies in Gibraltar in accordance with the English Law (Application) Act 1962. Unlike certain civil law jurisdictions, there is no general duty of disclosure in pre-contractual negotiations relating to digital token sales. Such a duty only exists when there are particular reasons for disclosure. These can be

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based on a pre-existing relationship between the parties (e.g., a fiduciary or confidential relationship)\textsuperscript{13} or when the nature of the contract carries specific duties of disclosure (this can be the case in consumer contracts, where duties of disclosure are imposed by the relevant legislation – see below).

Participants in digital token issuances dealing with token issuers at arm’s length are therefore expected to conduct due diligence. Unless one party’s mistake of fact is due to misrepresentation by the other party (or some other vitiating factor, such as duress), the parties will usually be held to their contractual commitments under Gibraltar law.

In short, a token issuer in Gibraltar is under no general duty of pre-contractual disclosure, but is prevented from inducing a purchase of digital tokens by misrepresenting (whether fraudulently or negligently) the nature of the arrangement.

B. IMPLEMENTATION OF E-COMMERCE AND CONSUMER PROTECTION REGULATIONS INTO GIBRALTAR LAW

All relevant E.U. legislation covering e-commerce and consumer protection has been transposed into Gibraltar law via various Acts of Parliament or Regulations. The E.U. e-commerce and consumer protection rules (E-Commerce Directive,\textsuperscript{14} Consumer Rights Directive,\textsuperscript{15} Directive on Distance Marketing of Consumer Financial Services\textsuperscript{16}) all specify the information that should be disclosed. The relevant provisions applicable under Gibraltar law are detailed below.

1. INFORMATION OBLIGATIONS WHEN GENERATING DIGITAL TOKENS VIA THE INTERNET

If the digital token is offered online, it falls within the scope of the E.U.’s e-commerce Directive, which has been transposed in Gibraltar through the Electronic Commerce Act 2001.\textsuperscript{17} Regarding the type of information that must be provided when concluding electronic contracts, Section 6(1) states:

A service provider shall ensure (unless agreed otherwise with a prospective party to the contract who is not a consumer) that the following information is available clearly and in full before conclusion of the contract –

(a) the steps to follow to conclude the contract;

(b) whether the contract, when concluded, will be accessible and, if so, where;

\textsuperscript{13} Tate v. Williamson LR 2 Ch App 55 (1866).
\textsuperscript{14} Directive 2000/31/EC of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market.
\textsuperscript{16} Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of consumer financial services.
\textsuperscript{17} Electronic Commerce Act 2001, \url{http://www.gibraltarlaws.gov.gi/articles/2001-07o.pdf}.
(c) the steps to follow to correct any errors made in input by the recipient of the service; further, such steps must be effective and accessible allowing the recipient to identify and correct any errors without difficulty;

(d) any general terms and conditions imposed by the service provider, further, such general terms and conditions must be accessible to the recipient of the service for him to store and retrieve them.  

2. DUTY TO PROVIDE INFORMATION UNDER CONSUMER PROTECTION LAW

If the contract on which a digital token is based constitutes a consumer contract, further consumer protection rules apply, as set out in the Consumer Rights on Contracts Regulations 2013 (which transposes, inter alia, the EU Consumer Rights Directive). These rules are highlighted under Part 2 of the Consumer Rights on Contracts Regulations 2013. The Regulations further split the specific information obligations in relation to off-premises and on-premises contracts under Schedule 1 and Schedule 2 respectively.

C. MONEY LAUNDERING

The E.U. Anti Money Laundering Directive has been transposed into Gibraltar law by the Proceeds of Crime Act (“POCA”). It should be noted that Section 9(1)(p) of the POCA now includes within the definition of “relevant financial business” that include “undertakings that receive, whether on their own account or on behalf of another person, proceeds in any form from the sale of tokenized digital assets involving the use of distributed ledger technology or a similar means of recording a digital representation of an asset.” POCA also requires reporting (by businesses and by the GFSC) when there is a suspicion (rather than actual knowledge) of money laundering. Essentially, the addition of the new definition of relevant financial business specifically brings sales of a tokenized digital asset clearly within existing AML laws, which in turn have been very well received by other service providers in the industry. Amongst other things, customer due diligence is required before a business may receive proceeds from the sale of tokenized digital assets. These businesses would also be required to appoint a money-laundering reporting officer (“MLRO”), as well as apply certain record keeping requirements. The business must also maintain an AML compliance program and report suspicious activity.

III. PROPOSED REGULATORY FRAMEWORK

As set out above, most often digital tokens do not qualify as securities under Gibraltar or E.U. legislation. In the event that they do constitute securities, there is currently an E.U.-wide framework
dealing with this. Accordingly, Gibraltar is not looking to introduce a framework that will replace securities law or prospectus directive requirements. That is to say, the public offering of tokens that constitute securities do not require further regulation from a Gibraltar perspective and will continue to fall under current frameworks governing issuances of securities.

As of the date of writing, we do not know the full extent of HMGOG’s legislative proposals for the regulation of digital token issuances, as the draft legislation has not yet been published. However, the Token Framework Proposal (“Framework”) provides a high-level outline of what lies in store. It is proposed that new legislation will regulate the following activities conducted in or from Gibraltar:

- The promotion and sale of digital tokens;
- The operation of secondary market platforms trading in digital tokens; and
- The provision of investment and ancillary services relating to digital tokens.

It is proposed the GFSC will regulate:

- Authorized sponsors of public digital token offerings;
- Secondary token market operators; and
- Digital token investment and ancillary service providers.

The Framework will not regulate:

- Technology;
- Digital tokens, smart contracts, or their functioning;
- Individual public offerings; or
- Persons involved in the promotion, sale, and distribution of digital tokens.

The following Sections set out at a high level the scope of the new proposed Framework.

A. DISCLOSURE RULES

The first limb of the Framework intends to deal with digital tokens that are not regarded as securities within the meaning of Gibraltar law. As set out above, this would typically cover circumstances where a digital token constitutes a product or service that does not yet exist (or is not substantially functional at the time of sale), in effect no more than a hope or ambition to deliver that product or service in the future. In such cases, purchasers risk that the product might never be delivered and often waive the right to the return on the price paid. HMGOG aims to ensure that whilst the purchaser
may be prepared to take that risk, it is appropriate that they be presented with all the relevant information to enable them to make an informed decision. This limb of the Framework will therefore counter the current position in Gibraltar whereby a token issuer is under no general duty of pre-contractual disclosure.

With respect to the promotion, sale, and distribution of digital tokens, the Framework will require adequate, accurate, and balanced disclosure of information to enable anyone considering purchasing digital tokens to make an informed decision. The regulations may prescribe what, as a minimum, constitutes adequate disclosure, and in what form disclosures are made (e.g., in a key facts document not exceeding two (2) pages). From time to time, guidance on disclosure rules may be published by GFSC.

The digital token industry often refers to the concept of “self-regulation,” and best practice frameworks for token offerings have already been established. The key difference with the proposed regulations is that the concept of self-regulation, while being attractive in the sense that it may be said to decentralize certain standards and requirements, it is also in many senses ‘voluntary’ and does not necessarily raise the standards through any legally enforceable framework such as the one being proposed in Gibraltar. As a result, the GFSC can ensure and enforce their regulatory objectives through the implementation of the Framework.

B. FINANCIAL CRIME PROVISIONS

As discussed above, a recent amendment to POCA under Section 9(1)(p) means that token issuers now fall under its scope. It remains to be seen whether this amendment is a temporary measure which will be replaced by specific regulations on AML and CFT once the Framework comes into force or whether these amendments were in fact what was contemplated in the Framework. Nevertheless, this demonstrates the intention of the Gibraltar Government to ensure that, even before the proposed digital token regulations come into force, existing statutory safeguards require all token issuers to carry out due diligence on digital token purchasers and to mitigate AML/CFT risks.

C. AUTHORIZED TOKEN SPONSORS

As outlined above, the GFSC intends to regulate:

» Authorized sponsors of public token offerings;

» Secondary token market operators; and

» Digital token investment and ancillary service providers.

It therefore appears that the onus of ensuring compliance with appropriate standards will be on the service providers and secondary token market operators and the GFSC does not intend to regulate token issuers, nor will it regulate the underlying technology or the digital tokens themselves.
The Framework will establish a regime for the authorization and supervision of token sponsors possessing appropriate relevant knowledge and experience who will be responsible for compliance with this limb of the regulations. It is intended that an authorized token sponsor will need to be appointed in respect of every public token offering promoted, sold or distributed in or from Gibraltar.

Token sponsors will be subject to an authorization and supervision process by the GFSC and must possess suitable knowledge and experience of the industry to be admitted into the sponsorship regime. A critical component for token sponsors to be authorized is to have local presence in Gibraltar, with “mind and management” based in the jurisdiction. The onus will also be on token sponsors to produce their own codes of conduct, setting out what they consider to be best practices relating to token offerings. These codes will form part of a prospective token sponsor’s application for authorization. The introduction of a token sponsor regime is comparable to what currently exists today in the U.K. in relation to regulated public market listings, where Sponsors and Nominated Advisors effectively act as listing agents that guide prospective issuers through the flotation process. It appears this same model is being adapted under the token sponsor regime to handhold prospective token issuing entities through a compliant token sale process.

The GFSC will establish and maintain a public register of authorized sponsors and their respective past and present codes of practice.

D. SECONDARY MARKET OPERATIONS

Apart from the DLT Framework, operating a secondary market platform for trading tokens is not currently regulated in Gibraltar. The Framework will regulate the conduct of secondary market platforms, operated in or from Gibraltar and, to the extent not covered by other regulations, their derivatives, with the aim to ensure that such markets are fair, transparent, and efficient.

At this stage, the Framework does not elaborate on the specific regulatory obligations that will be imposed. However, it does highlight the introduction of further transaction reporting and disclosure requirements, as well as extending the application of the Framework to cover trading of derivative token products. The Framework does, however, mention modeling the proposed regulations on market platform provisions under MiFID II and the Markets in Financial Instruments Regulation (MiFIR), so far as is appropriate, proportionate, and relevant.

E. INVESTMENT AND ANCILLARY SERVICE PROVIDERS

Providing investment and ancillary services relating to digital tokens is not currently regulated in Gibraltar. HMGOG has proposed to regulate the provision of investment and ancillary services in or from Gibraltar and, to the extent not otherwise caught by regulations, their derivatives. These

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regulations aim to ensure that such services are provided fairly, transparently, and professionally. This limb of the Framework will intend to cover advice on investment in digital tokens, virtual currencies, and central bank-issued digital currencies, including:

» generic advice (setting out fairly and in a neutral manner the facts relating to token investments and services);

» product-related advice (setting out in a selective and judgmental manner the advantages and disadvantages of a particular token investment and service); and

» personal recommendations (based on the particular needs and circumstances of the individual investor).

This limb of the Framework will be proportionately modeled on provisions that currently exist under MiFID II with the aim of ensuring that such services are provided fairly, transparently, and professionally. However, at this stage, little guidance has been given on the specific types of advisors involved in a digital token distribution process that will be caught by the proposals (e.g., introducers, marketing professionals, technical developers and smart contract auditors, economic, legal and tax advisors, cybersecurity firms, escrow agents, etc.).

IV. DLT SERVICES

As set out above, the DLT Framework is a licensing regime for individuals and firms that engage in activities that, for business purposes, use DLT for the transmission or storage of customers’ assets. It is generally accepted that the DLT Framework does not extend to the generation and sale of digital tokens. This is in line with public statements made by various bodies, including HMGOG, and is consistent with the Framework which will be introduced for these purposes. However, there may be instances where a token issuer may fall within the scope of the DLT Framework, although this should be considered separately from the actual digital token sale, which may remain unregulated until the new legislation referred to above comes into effect.
UNDERSTANDING DIGITAL TOKENS

Legal Landscapes Governing Digital Tokens in Gibraltar