



Astana Financial Services Authority

Consultation Paper

No. 4 of 2018

**Proposed Amendments to
AIFC Regulations and Rules on
Virtual Currencies and
Extended Private Placement Regimes**

May 25, 2018

Introduction

1. The Astana Financial Services Authority (“AFSA”) has issued this Consultation Paper to invite public feedback and comments on the proposed amendments to the Astana International Financial Centre (“AIFC”) Regulations and Rules on regulation of Virtual Currencies, facilities offering trading of Virtual Currencies, and regimes for alternative sources of funding for businesses.
2. The proposed amendments are set out in Annexes 1 – 6 to this Paper.
3. This Consultation Paper may be of interest to a number of parties, including individuals, investors and organisations looking to carry on activities related to Virtual Currencies in or from the AIFC and Authorised Persons, Designated Non-Financial Business or Professions, Registered Auditors, and financial organisations.
4. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use “Consultation Paper No 4” in the subject line. You may, if relevant, identify the organisation you represent when providing your comments.
5. The AFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise. Comments supported by reasoning and evidence will be given more weight by the AFSA.
6. **The deadline for providing comments on the proposals is 25 June 2018.** Once we receive your comments, we shall consider if any refinements are required to the proposed amendments.
7. **Comments to be addressed to:**
Consultation Paper No 4
Innovation Policy Division
Astana Financial Services Authority (AFSA)
8 Kunayev Street, Building B, Astana, Kazakhstan
or emailed to: Fintech.Consultation@afsa.kz
Tel: +7 (7172) 647260

Background

1. The emergence and recent development of the Distributed Ledger Technology (“DLT”) is disrupting financial markets, institutions and regulators around the world. New disruptive technology and innovative products (digital investments) built on it have the potential to transform financial markets across the globe, and place competitive pressure on incumbent service providers.
2. By encouraging the growing trend towards financial disintermediation in the traditional financial industry, DLT has the potential to radically change the way assets are maintained and stored, obligations are discharged and contracts enforced.
3. Today, the digital assets (including Virtual Currencies) market is represented by more than 100 digital asset exchanges and more than 1000 different digital assets, each with varying characteristics and uses. Some digital assets, like Bitcoin, function as a Virtual Currency, while others can represent a right to tangible assets like gold or real estate. Digital assets can also be used in new protocols to create means of internal settlement within a specific platform or represent a share of ownership in a company.
4. The digital assets (including Virtual Currencies) market is growing at a considerable rate, escalating the need for compliance with regulatory standards and mounting concerns about the future of the industry.
5. Over the last few years, a number of financial services regulators have issued comments and consumer alerts setting out their regulatory position on “virtual or crypto-currencies” without first providing their definitions. As regulators around the world begin to grapple with the challenges presented by digital assets, it has become apparent that they lack a definitional vocabulary that accurately reflects the different forms “Virtual Currency” may take.
6. In this regard, following the report of the Financial Action Task Force (FATF) on Virtual Currencies, a handful of places like the USA, Japan, and the Philippines, developed regulatory frameworks governing activities related to Virtual Currency. Others are now considering the introduction of legislation to provide a regulatory framework for Virtual Currency.

Proposed Legislative Framework

Regulatory Approach

1. The Framework is being developed by the AFSA as part of enhancing regulatory policies aimed at facilitating the adoption of technological innovations in the AIFC.
2. Accepting that the law never will completely keep up with the pace of technological developments, it is necessary to adopt legislation that will be flexible and open to future developments, and not favour a particular technology over another.
3. Thus, the central objective of drafting the Framework is to create conditions that foster innovation in the AIFC whilst ensuring that technology neutrality is arguably achieved.

Proposed Amendments

4. The proposed framework will involve amendments to the AIFC's legislation to:
 - (a) provide definitions and classification of the various types of Virtual Currencies based on their different business models and methods of operation, as well as definitions of the most important terms related to Virtual Currencies,
 - (b) introduce a new regulated activity of Operating a Virtual Currency Trading Facility, and extend the current definition of the regulated activity of Providing Custody to include safeguarding and administering Virtual Currencies belonging to another Person,
 - (c) extend the current exempt offering regime for the offer of Securities by way of placement,

whilst ensuring effective investor protection and financial market integrity.

Definition of basic notions related to Virtual Currencies

5. A common set of terms reflecting how Virtual Currencies operate is a crucial first step for regulators, government officials, law enforcement, private sector entities and investors to understand risks and potential benefits they offer.
6. There is no generally recognised definition and classification of Virtual Currencies either in Kazakhstan or internationally. Thus, in categorising Virtual Currencies and defining key terms related to Virtual Currencies, the AFSA bases its approach on definitions provided in the report of the FATF: "Virtual Currencies – Key Definitions and Potential AML/CFT Risks" and legislation of the USA, Philippines and Japan.

Operating a Virtual Currency Business

7. This part outlines the proposed approach to regulate activities of custodians and Virtual Currency exchanges that are involved in trading Virtual Currencies ('Operators of Virtual Currency Businesses').
8. Noting that Virtual Currency markets have so far been predominately Retail, in formulating the Framework, the AFSA proposes to limit activities of Operators of Virtual Currency Businesses to trading of digital (non-securities) assets only, which are Virtual Currencies.
9. Given that the activities of Operators of Virtual Currency Businesses have some similarities with activities of Authorised Investment Exchanges and Authorised Custodians, regulatory requirements applying to Operators of Virtual Currency Businesses will be developed on the basis of principles, requirements and provisions of existing AIFC rules, taking into account the specificity of new activities.
10. An applicant that intends to carry on activities of either or both of a Virtual Currency Trading Facility and a custodian for Virtual Currency shall, pursuant to Section 34 of the AIFC Financial Services Framework Regulations ("FSFR"), demonstrate that it:
 - (a) has adequate and appropriate resources, including financial and technology resources;
 - (b) is fit and proper;
 - (c) is capable of being effectively supervised; and
 - (d) has adequate compliance arrangements, including policies and procedures, that will enable it to comply with all the applicable legal requirements.
11. Once granted a Licence, Operators of Virtual Currency Businesses will be regulated under the FSFR and the AIFC rules as Authorised Persons. They must also comply with all requirements applicable to Authorised Persons in the following AIFC rules, unless the requirements in this chapter or AIFC rules expressly provide otherwise:
 - (a) the AIFC Conduct of Business Rules ("COB");
 - (b) the AIFC General Rules ("GEN");
 - (c) the AIFC Anti-Money Laundering, Counter – Terrorist Financing and Sanctions Rules ("AML");
 - (d) the AIFC Prudential Rules for Investment Firms ("PRU INV").

Exempt Offerings / Offerings by Way of Placement

12. The advent of DLT has sparked a new form of fundraising for startups, small and medium-sized enterprises, called "Initial Coin Offerings" (ICOs). The digital assets (tokens) issued during these transactions have different

characteristics specific to each transaction, where some of them exhibit the characteristics of equity or debt Securities.

13. For regulatory purposes, issuances of Securities, whether through a DLT platform or other means, should see no difference in their treatment under the AIFC regulatory framework.
14. Therefore, the central objective of drafting amendments to the AIFC Markets Rules is to create a regime to support innovative methods of raising funds that comply with international best practice in the field of Securities regulation. This means ensuring that the rules drafted are broadly in line with the existing AIFC regulatory framework, and are informed by international experience.
15. In developing a new fundraising regime, the AFSA proposes to model its Private Placement regimes of the US (Regulation D), which are considered as one of the most advanced in the world and which foster innovation and entrepreneurship in the USA, and the Abu Dhabi Global Market and the Dubai International Financial Centre (UAE).
16. Because of the risks involved with this type of investing, it is proposed to set limits on the amount that retail investors can invest during any 12-month period in these transactions. The limitation on how much retail investors can invest shall depend on their net worth and annual income.

Risk Mitigation

17. Many of the risks posed by Virtual Currencies and related activities are similar to the risks presented by other operators of exchange, clearing house and custody, but some are specific to operators of a Virtual Currency Trading Facility and issuers of Virtual Currencies.

AML/CTF/Tax

18. One of the main risks associated with Virtual Currency payment products and services is money laundering and terrorist financing (“ML/TF”) risks.
19. According to “the Guidance for a Risk-Based Approach to Virtual Currencies” issued by the FATF, regardless of whether a country opts for prohibiting or regulating Virtual Currencies, additional measures are required to mitigate the overall ML/TF risk.
20. Even if a country decides not to regulate Virtual Currencies with respect to non-ML/TF risks, such as consumer protection, prudential safety and soundness, and network security, it should take prompt action to identify, assess, and apply a risk-based approach to mitigate the ML/TF risks associated with Virtual Currencies under the relevant FATF Recommendations.

21. Prohibition of Virtual Currencies might have a negative impact on the local and global level of ML/TF risks, as prohibition could drive them underground, where they will continue to operate without AML/CFT controls or oversight.
22. In this regard, following an analysis of the risks associated with Virtual Currencies, the FATF recommends that countries should address ML/TF risks associated with Virtual Currencies exchanges and any other types of institutions that act as nodes where convertible Virtual Currencies intersect with the regulated fiat currency financial system, by applying the relevant FATF Recommendations to any of these Virtual Currencies exchanges and any other types of institutions that act as nodes.
23. Accordingly, the proposed Framework involves amendments to the FSFR and GEN to apply requirements and provisions of the existing AIFC AML Rules and Law of Kazakhstan on AML in full to the new market activity of Operating of a Virtual Currency Trading Facility.
24. This includes (without limitation) the submission of reports on suspicious and threshold transactions to the Financial Monitoring Committee of the Ministry of Finance of the Republic of Kazakhstan, conducting proper Know Your Customer and Customer Due Diligence procedures, transaction monitoring, identifying the source of funds and wealth, sanctions monitoring and appointment of a Money Laundering Reporting Officer.

Consumer Protection, Technology Governance

25. Virtual Currencies must comply with not only AML/CFT requirements, but also other regulatory obligations, including consumer protection, prudential safety, and internal and network IT security standards.
26. In general, Operators of a Virtual Currency Trading Facility as an Authorised Market Institution will be regulated in a manner similar to the AFSA's regulation of Authorised Persons, and will be required, among other requirements, to disclose all material risks associated with Virtual Currencies and their trading, and key information on their operations, internal controls, and safeguards to protect customer assets.
27. Also, customer protection measures will include establishing and maintaining written policies and procedures by Operators to fairly resolve complaints in a timely manner, and setting limits on transactions for retail investors who enter into securities transactions under Exempt Offerings regime for the offer of Securities by way of placement based on their income and net worth.
28. Given the ever-increasing risks to data and cyber-security, besides general requirements in Section 2 of the AIFC Authorised Market Institutions Rules applicable to all Authorised Market Institutions, there will be a new "Rules applicable to Authorised Virtual Currency Trading Facility" with additional requirements, including the implementation of a written cyber security

policy setting forth its policies and procedures for the protection of its electronic systems and members and counterparty data stored on those systems, which shall be reviewed and approved by the Authorised Virtual Currency Trading Facility's governing body at least annually.