

# Business & Finance

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Business in the modern world looks dramatically different from how it did back in the days of the country store that accepted credit and barter. Companies now sell their goods internationally and interact with clients all over the world. Technology has played a huge role in changing the way business is done, and makes running a business in the modern world more possible. Today, with email, cell phones, teleconferencing and video chats, it's possible to have a company meeting with clients and employees all over the world — as if they were all sitting in the same conference room. From the time of the cotton gin or the first shoe assembly line, technology has dramatically

increased business efficiency and production. Automated warehouses and shipping have also become common, helping to meet increased demand, complete with automated labeling with bar codes to keep track of the size, weight and destination of every package that is sorted through the system. Since companies are able to sell to customers all over the world, consumers can be more picky about which businesses they choose to patronise. This means the modern businesses have to fight harder to keep their customers loyal, and to stand out from the competition. Social media has provided a valuable tool for businesses to connect with their clientele and have a more personal conversation with

them. With consumers becoming even more connected through smartphones and tablets, businesses will have to continue to adapt in order to be transparent and to offer the best customer service possible. And with new tools like cryptocurrencies and blockchain, companies will need to adapt even more. As is often the case, those that manage to embrace these evolving technologies first - and best - will enjoy a huge advantage over their competitors. In this supplement, we take a close look at how blockchain and cryptocurrencies look set to change the world as we know it. The world of business and finance is no exception.

# Malta – A leader in DLT regulation



**Silvio Schembri**

*Parliamentary Secretary responsible for Financial Services, Digital Economy, and Innovation*

Throughout the years, Malta has managed to re-invent itself several times. From an economy based on the textile industry and other low value added manufacturing, it has transformed itself into one based on services, high-level manufacturing and knowledge-based activities.

This was possible thanks to Malta's constant innovation and investments in its infrastructure: physical, institutional or legal, as well as its human resources. The presence of a robust regulatory support infrastructure offers access to a full range of services and products and offers certainty that has also played a pivotal role.

The last years have seen the proliferation of new and disruptive technology that will have material impact on the majority of industries including the financial services, education and health, logistics, transport and public administration as well as others such as online gaming and intellectual property.

We're at a crossroads. Malta has a choice to make: either to follow others or to lead. We have opted to lead. Leading by being proactive, by being open to business, and by establishing the right legal infrastructure to attract entrepreneurs and investors from all over the world. In doing so, Malta can be transformed into an international hub for new, emerging and innovative technology, especially Blockchain.

The uses of Blockchain are almost infinite. They range from financial services where a growing number of financial services firms are using this technology to introduce innovations, such as smart bonds and smart contracts to asset management. Other applications include public sector services, for example, having patients' encrypted health information shared with multiple providers without the risk of privacy breaches.

The framework that the Government is proposing will offer legal certainty in a space that is currently unregulated. The framework touches upon a number of issues including types of authorisations, legal personality, and the applicability of law on smart contracts. We believe this will foster the creation of a new economic sector that potentially can be as big as the remote gaming sector or the financial services. It can also help in the further development of existing sectors and the creation

of new ones as it will usher additional foreign direct investment in Malta, the transfer of know-how and related skills and new specialist opportunities for our community.

The framework proposed consists of three pieces of legislative changes. One involving the setting up of a specialised authority; another separate Bill will set out the regime for the registration of Technology Service Providers and the certification of Technology Arrangements, while a third Bill will set out the framework for ICOs and other services related to virtual currencies. The latter will also include intermediaries such as brokers, exchanges, wallet providers, asset managers, investment advisors and market makers dealing in virtual currencies.

The new authority will promote governmental policies that favour the development of Malta as a centre of excellence for technological innovation and will, among other things, help to safeguard Malta's reputation by implementing the best standards in the sector. The authority will also play a vital role in the protection of users and consumers, in particular when either directly or indirectly, they will interface or use this technology.

We will be taking a principle-based approach, thus avoiding putting unnecessary burden on industry. The new legislative framework will help to separate products and services that offer return and value added from those that are frauds. It will set standards that will help ensure compliance in terms of our international obligations, including anti-money laundering.

These changes should also see the further development of Fintech and Regtech, two sectors that are expanding at a rapid rate. Looking around, one can easily note that funding for Fintech companies is on the rise, support for the industry from governments is increasing and an abundance of both incubators and accelerators are offering startups the means and assistance to grow within the industry. We aim to be at the forefront of this new wave of innovation. Our target is to create the right environment and the right incentives to attract business – directly related to Fintech and Regtech – to Malta from all over the world.

In line with the Government's political mandate, these changes will help

Malta to further diversify its economic output, rendering it more resilient to external shocks. This will help in stimulating economic growth through technology led innovation, and will put Malta on the global map as a major hub for this kind of innovative technology. It will ensure that future generations benefit from the initiatives we are taking today.

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## INTERVIEW

# Gearing up for a technological revolution

Blockchain and cryptocurrencies are gaining more traction in mainstream business. PAUL COCKS spoke to JEAN-PIE GAUCI-MAISTRE, Managing Director of Gauci-Maistre Xynou, about how the industry is preparing for official adoption of the technologies

**Bitcoin has raised the question of whether computer code, rather than a central bank, should control the money supply. But is it desirable for society to allow a digital money system which enables its users to operate outside the remit of the law, unlike physical cash which is more regulated?**

It is true that at the moment in most jurisdictions around the world the use of bitcoin, and cryptocurrencies in general, is not adequately regulated. As a result, a system seems to have been created that runs in parallel to the traditional fiat currency system. This phenomenon in combination with the specific characteristics of cryptocurrencies such as the anonymity in the transactions, the absence of a central authority and its immutability, creates loopholes in sectors like investment protection, taxation law, database protection as well as criminal law while risks related to anti-money laundering and financing of terrorism also need to be tackled.

At the same time, Bitcoin and other cryptocurrencies are so widely used that they have become a reality which could change the way the entire financial market works. Considering the function of law as the means of organised societies to control and regulate the actions of their members we believe that it is crucial for legislators to take action and adapt the appropriate regulatory measures. Issues such as the legal nature of cryptocurrencies and their connection to traditional (fiat) currencies, the legal requirements for the setting up and operation of firms investing or trading in cryptocurrencies, and the protection of investors and investments in this field should be adequately addressed. When this happens, the law should provide the necessary security safeguards so that society can be sure that it is protected from the negative side effects of any unlawful use of virtual currencies. The Government of Malta has consistently shown that it wants to be a leader in this sector and has taken active steps to regulate the industry, in consultation with industry stakeholders. Regulators all over the world are currently playing catch-up, however, credit must be given to both the Maltese Government, the regulator and the private sector for their initiatives in ensuring that Malta is at the forefront of this industry.

**Unlike Bitcoin, which has been running since 2009, use of blockchain in banking remain largely experimental. One vision is for a single database maintained and accessed by the biggest banks to execute and settle trades. Do you see this becoming reality? What immediate use can you envisage for blockchain technology?**

The applications of blockchain technology can be numerous. Although at present the use of blockchain in different industries is indeed at an experimental stage, it can have a significant effect in the way the markets function and in the way business is conducted. Based on its characteristics blockchain can provide safety, transparency, efficiency and reduce costs whilst reducing the time required for executing transactions.

The potential benefits of blockchain in the banking sector are undoubtedly appealing and it should come as little surprise that huge amounts of resources are invested by major international organisations. Within the next years we will likely see blockchain implemented in



Jean-Pie Gauci-Maistre

very much the same way as the internet pervaded in the nineties.

In this context and taking for granted the impact which a database unification project for the largest banks may have in terms of cost and labour savings, although the process is very complex and needs to be implemented with the cooperation of specialists of many sectors in order to operate smoothly, sooner or later it will become reality.

Naturally, the investment required is immense as security is of paramount importance. Vulnerabilities have been discovered and exploited in the past and this was witnessed on a large scale a few years ago with respect to the Distributed Autonomous Organisation. Whilst not related to the banking industry, this case did show that vulnerability in the programming of a smart contract led a hacker to drain the DAO of its cryptocurrency 'Ether'.

Nonetheless, in the meantime blockchain can be used by and benefit banks in several ways. In KYC procedures blockchain can provide more efficiency and security with respect to the implementation of Anti-Money Laundering legislation on an international level. It can be used to reduce intermediaries and make international payments and transfer of money less expensive and faster, and reduce the paperwork needed for the completion of complex transactions. In addition blockchain and especially smart contracts can have significant benefits in side sectors of the banking business such as insurance and the real estate industries.

**One of the most radical ideas for blockchain technology is the notion of digitising law. The industry jargon is "smart contracts" – code on a shared database that automatically executes a contract based on the fulfilment of certain real-world conditions, just as a vending machine obeys rules to provide sweets when money is inserted. But is it desirable, or even possible, that contracts become inescapable chains?**

As lawyers, the development of smart contracts is one of the most intriguing aspects of blockchain. To begin with we read with more frequency that the role of a lawyer will diminish as a result of smart contracts or that contracts as we know them will soon become a thing of the past. So naturally this is an area of interest. I am of the opinion that the term 'smart contract' may be a bit misleading and is being given more importance than it deserves, from a legal aspect.

Smart contracts in essence will be capable of executing certain instructions based on the criteria built into the code. This is nothing new in and of itself and would function no different to an

automatic pay-out or purchase of shares on a pre-determined trading price of the stock. With respect to a smart contract, we see something similar in relation to the role of an escrow agent in a sale and purchase. In this case, the escrow function could indeed be deemed to be 'smart'. However, the smart contract should be viewed as a tool that would work in tandem with a contract, in the more traditional sense of the word.

There are various aspects that need to be given serious thought with respect to smart contracts but one point in particular is related to that aspect of Distributed Ledger Technology which is often touted as one of its biggest advantages, that is, its irreversibility of transactions. However, in reality, we have to contend with amendments to the law, a change of intention by the contracting parties, the possibility of a party to a contract acting without authority, etc. Such scenarios require a rectification as the original instructions are no longer aligned with the law or the contracting parties' intentions. In such cases, the immutability of smart contracts is something that may become a shortcoming unless tackled adequately.

In the short term I believe that the more straightforward and standardised transactions would be serviced well by smart contracts. This should undoubtedly be to the satisfaction of many and have considerable beneficial effects on the market and society in general. The straightforward execution of contracts based on clear-cut terms and conditions, the avoidance of long-term disputes, the facilitation of business, the reduction of cost and time of transactions and even the elimination of bureaucracy are just some of the benefits which cannot be dismissed.

However, for the more complex transactions, the industry needs more time to mature. Humans will be humans, that is to say, they have opinions and are conditioned by various factors that will lead to divergent views and disagreement on interpretation. As long as this is the case, the legal profession will continue to survive.

**Is blockchain suitable for any organisation? And, if so, how should Maltese organisations think about applying it and what would this mean organisationally and culturally?**

The consultation document on the establishment of the Malta Digital Innovation Authority and the framework for the Certification of Distributed Ledger Technology Platforms and Related Service Providers; and a Virtual Currency Act is indicative of what a cross-sector revolution we are experiencing. The Government of Malta is anticipating an overlap between various competent authorities in Malta and the proposed Media Digital Innovation Authority. This in itself is a clear indication of how far-reaching the effects of blockchain are going to be. Whilst I am a great proponent of less regulation and greater implementation and avoiding additional layers of bureaucracy, I firmly believe that at this stage the proposed "Joint Co-Ordination Board" will be extremely beneficial. The effective cooperation between the proposed Media Digital Innovation Authority and the various competent authorities will be crucial. The key point is that all of us, from our respective sectors pull the same rope.

Organisations should approach blockchain technology in a very similar manner. The personnel concerned in the

various departments need to be made aware of what the technology has to offer and how it would be adopted. Transmission of the correct information is key as all too often technology is associated with requiring less manpower and thus leading to redundancies of current employees, which makes implementing the changes that much harder. Blockchain has several benefits to offer any organisation. Transparency, security and integrity of information, high level of trust and public verifiability constitute a few of the key advantages. In addition, it could also provide cost and time savings. However this does not mean that the use of blockchain makes sense for every single organisation no matter what the specific needs and structure of it are.

Organisations that need to store large amounts of data, particularly when the information is distributed among multiple parties/entities, stand to benefit through the use of blockchain. What would otherwise lead to issues of poor communication or confidentiality could help organisations dealing with supply chain management, banks, healthcare units, insurance companies and real estate agencies streamline their procedures. Even the public sector stands to benefit by the use of blockchain and smart contracts applications.

**What is your firm doing to prepare itself and its clients for blockchain and its effects?**

Ironically enough we have set up a centralised system at our firm to prepare ourselves for the use of blockchain across the various practices in which we are active. A core team have been familiarising themselves with blockchain and virtual currencies and have begun introducing the concepts to the various departments. Adopting this approach was a conscious decision. Blockchain is a culture change that has the potential to sweep across all sectors of our economy. That means that we all need to familiarise ourselves with the pros and cons of blockchain and how it will integrate into our practice. When we achieve this, it is only then that we can move away from our centralised system that we have adopted. A culture change does not happen overnight, cannot be forced (although it must be given a bit of a nudge) and is not always easily accepted.

Our firm was founded on the principle that we can only provide the best service possible if professionals from both the legal and accountancy profession collaborate. Having this at our core helps us understand that we need to accept other professionals into the fold, in this case IT professionals. Their technical knowhow is crucial.

We are naturally keeping abreast of all the developments going on locally and internationally. It is very satisfying to hear that many industry players are contributing to the various consultation papers that are being issued by the Government and the MFSA. This is crucial to the industry and we are pleased to have contributed to the "Supplementary Conditions applicable to Professional Investor Funds ('PIFs'), investing in Virtual Currencies ('VCs')" and the "Discussion Paper on Initial Coin Offerings, Virtual Currencies and related Service Providers". We likewise intend to provide our feedback to the Consultation Document issued by the Parliamentary Secretary for Financial Services, Digital Economy and Innovation.



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