



Developing disclosures - Risk factors and disclosures for blockchain-based instruments and digital asset issuances

December 2023

Bourn Collier and Sharon Beesley

The International Capital Markets Association (ICMA), the membership organisation which promotes the development of the international capital and securities markets, recently published a report by a working group with results of a review focused on offering documents for issuances of fixed income securities constituted using distributed ledger technology (DLT, and such instruments referred to as DLT-based instruments)¹

The review, carried out by the DLT Bonds Legal Subgroup, analysed recent offering documents and final terms for issuances of DLT-based debt instruments with a view to identifying, commonalities and areas of consensus as to the scope and nature of risk factors which may assist issuers and underwriters (although the Subgroup did not include recommendations for form of model documentation). The review involved consideration of around a dozen offering documents and final terms used for the issuance of DLT-based instruments, of which seven are publicly available. The governing law of the instruments included French, Spanish, Swiss, Luxembourg, Australian, German, Hong Kong and English law. Issuers included supranationals such as the World Bank (International Bank for Reconstruction and Development) and the European Investment Bank as well as financial institutions such as UBS and Société Générale.

The Subgroup identified the reviewed offering documents typically did include additional risk factors specific to DLT and these would most often include disclosure of risks which the Subgroup grouped under the categories of technology risks, legal and regulatory risks and liquidity risks. For the examples which the Subgroup included in

¹ <https://www.icmagroup.org/assets/Considerations-for-risk-factors-and-disclosure-in-DLT-bond-offering-documents-November-2023.pdf>

settlement environment (including the inability to list and admit to trading DLT-based instruments in certain jurisdictions) and public trust and awareness of DLT systems.

The Subgroup also identified disclosures which were less frequent in the sample group but notable (and likely of future relevance), including as to the type of DLT platform (architecture), the nature of intermediaries and transfer mechanisms. The Subgroup also noted relevant factors which may be explored in future – such as the settlement architecture (and constitution of cash, whether on or off-chain, including as part of a CBDC) and the interface with regulated market infrastructure environments (such as listing venues and central securities depositories).

The Bermuda perspective

Bermuda, a jurisdiction in the Mid-Atlantic with a sophisticated financial services industry has had a legislative and regulatory regime for DLT-based instruments since 2018 with the introduction of the Digital Asset Business Act 2018 (DABA), in respect of undertakings carrying out business in respect of digital assets and Digital Asset Issuance Act 2020 (DAIA), in respect of an accompanying regulatory regime overseen by the island's integrated financial services regulator, the Bermuda Monetary Authority (BMA).

Under DABA, a wide definition of "digital assets" is adopted – "anything that exists in a binary format and comes with the right to use it and includes a digital representation of value" (with limited exceptions²), with the effect that there is a single approach adopted by the BMA in respect of all businesses which apply for licenses to carry out business involving digital assets (DABA Licences), which does not make a conceptual distinction between fixed income securities or other assets. The same definition of "digital assets" is adopted in respect of digital asset issuances under DAIA (which is intended to regulate activities to fund a DAIA licensee's own company or project, and which has attracted few applicants relative to DABA).

Thus the ICMA recommendations and market practice in respect of DLT-based (fixed income) instruments may prove to be equally well applicable across the full range of DABA Licence holders and their range of products.

Client Disclosure rules and BMA Guidance

Of the 25 current DABA Licence holders, a significant number undertake business of operating a digital asset exchange (or derivatives exchange) or the issue of stablecoins (or activities related thereto). Particularly for instruments or digital assets like stablecoins, the issuer of the asset held by investors will be hold a DABA Licence, and therefore will be required to make risk disclosures to investors by virtue of a risk disclosures regime set out in

² DABA section 2.

the Digital Asset Business (Client Disclosure) Rules 2018 (the DAB Client Disclosure Rules).

Under the DAB Client Disclosure Rules, every licensed undertaking prior to entering into an initial transaction for, on behalf of, or with a client shall disclose to such client all material risks associated with its products, services and activities; and any additional disclosure the BMA determines reasonably necessary for the protection of clients (which must be made separately from any other information provided by the licensed undertaking to the client)³. The DAB Client Disclosure Rules, also require specific disclosures in respect of risk mitigation be made to clients (to the extent such matters are applicable to the product or service to be provided), including whether insurance coverage for cybersecurity incidents has been obtained and remedies for unauthorised, accidental or mistaken transfer of client digital assets, (as well as the revocability of digital asset transfers and the ability of clients to stop such transfers)⁴.

From a review of the websites and documentation of many of the current DABA Licence holders, we noted that they have tended to include risk disclosures in respect of the same cybersecurity, liquidity and regulatory risks as identified by the ICMA Subgroup.

Areas we anticipate of future development of risks disclosures include (i) where complex operating structures (particularly in respect of custodied digital assets) are launched and enhanced disclosures are sought by the BMA to ensure adequate customer protection and (ii) as greater institutional adoption of digital asset businesses leads to an increase in clearing and settlement activities, more detailed analysis and disclosure of risks arising in respect of clearing and settlement will feature in the documentation circulated by DABA Licence holders, which may converge with and be informed by DLT-based fixed income instruments and standardised forms prevalent in those markets.

In conclusion, the rapid development of distributed ledger technology has prompted an evolution in market practice and awareness for international securities markets. The convergence by digital asset firms, including in jurisdictions with licensing regimes such as in Bermuda will likely increase.

³ DAB Client Disclosure Rules, section 3(1).

⁴ Ibid, section 3(3).



Sharon A. Beesley
Managing Partner & Head of Corporate
sabeesley@beesmont.bm
+1 441 474 9000



Bourn Collier
Senior Corporate Counsel
bcollier@beesmont.bm
+1 441 400 4747