

# The Financial Instrument Test

**James Farrugia**

GANADO Advocates

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# The Financial Instrument Test

The VFA Act provides that a “DLT asset” is:

- i. a virtual token;
  - ii. a virtual financial asset;
  - iii. electronic money; or
  - iv. a financial instrument,
- that is intrinsically dependent on, or utilises DLT.

# The Financial Instrument Test

- Unlike what the name implies the Financial Instrument Test is used for the purposes of the classification a DLT Asset as a: (A) a virtual token; (B) virtual financial asset; (C) electronic money; or (D) a financial instrument.
- The FI Test is essentially an excel file and a guidance note issued by the MFSA.

# The FI Test – E Money

- The VFA Act, refers to the Financial Institutions Act for the definition of electronic money
- We need to determine whether the DLT Asset qualifies as electronic money

# The FI Test – E Money

- "electronic money" means electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions .... and which is accepted by a natural or legal person other than the financial institutions that issued the electronic money

# The FI Test – E Money

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT issued by the issuer on receipt of funds at par value, and redeemable at par value with the issuer upon request of the holder? **[YES]**

# The FI Test – E Money

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the holder of the DLT Asset have a claim against the issuer's assets arising from the funds originally placed against the issuance of such DLT assets? **[YES]**

# The FI Test – E Money

- MFSA Guidance Note looks at the following attributes:
  - iii. Is the DLT Asset used for the purpose of a payment transaction, which may be initiated by the payer or by the payee, of placing, transferring or withdrawing funds, irrespective of any underlying obligations between the payer and the payee? **[YES]**



# The FI Test – E Money

- For a DLT asset to qualify as Electronic Money, (a) the DLT asset should not fall within the exemption specified in Article 3(k) of Directive (EU) 2015/2366 and (b) the payment transaction should not fall within the exemption specified in Article 3(k) of the said Directive - **Limited Network Exemption.**

# The FI Test – Virtual Token

- “virtual token” means a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform on or in relation to which it was issued or within a limited network of DLT platforms:

# The FI Test – Virtual Token

Provided that the term "DLT platform" referred to in this definition shall exclude DLT exchanges.

Provided further that a virtual token which is or may be converted into another DLT asset type shall be treated as the DLT asset type into which it is or may be converted.

# The FI Test – Virtual Token

- MFSA Guidance Note looks at the following attributes:
  - i. Does the Token Standard allow the DLT asset's conversion into another DLT asset type? Token Standard is a technical specification that defines a common list of rules applying to every DLT asset on a particular DLT network and by which every DLT asset interacts with others on the said network **[NO]**

# The FI Test – Virtual Token

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the Token Standard support Atomic Swapping or any other type of interoperability outside (i) the DLT platform on or in relation to which it was issued or (ii) a limited network of DLT platforms? **[NO]**

# The FI Test – Virtual Token

- MFSA Guidance Note looks at the following attributes:
  - iii. Does the issuer intend to list or admit a DLT asset to trading on an exchange, either locally or abroad? **[NO]**
  - iv. Is the DLT Asset a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services? **[YES]**

# The FI Test – Fin. Instrument

- “financial instrument” shall have the same meaning assigned to it under the Second Schedule to the Investment Services Act, whether or not issued in Malta
- Covers: (A) Transferable Securities, (B) Money Market Instruments, (C) Collective Investment Schemes, (D) Financial Derivative Instruments and (E) Emissions Allowances.

# The FI Test – Fin. Instr. (TS)

## **A. Transferable Securities**

- Focus on (A) Maturity, (B) Features of the DLT Asset, (C) Exchangeability and (D) whether it classifies as an instrument of payment.



# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - i. Does the DLT Asset have a maturity at issuance greater than 397 days? **[YES]**;

# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Is DLT asset used to initiate / conclude a transaction to buy goods/ services as agreed between two or more parties and accordingly functions as a means of payment/ medium of exchange i.e. acts as an instrument of payment? **[NO]**

# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is DLT Asset negotiable or capable of being traded on the capital market? **[YES]**

# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features **[YES]**:
    1. Right to participate in the capital of the issuer
    2. Right to receive proceeds from the liquidation of issuer in excess of nominal value

# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features **[YES]**:
    - 3. Entry in the register of shareholders
    - 4. Right to a principal amount due of fixed sum with fixed/ variable maturity

# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features **[YES]**:
    - 5. Entry in the register of debenture holders
    - 6. Right to acquire or sell a transferable security

# The FI Test – Fin. Instr. (TS)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT Asset exhibit any of the following features **[YES]**:
    - 7. Right to an amount settled in cash determined by reference to transferable securities, currencies [FIAT], interest rates or yields, commodities or other indices or measures

# The FI Test – Fin. Instr. (MMI)

## **B. Money Market Instrument**

- Focus on (A) Maturity, (B) Features of the DLT Asset, (C) Exchangeability and (D) whether it classifies as an instrument of payment.



# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - i. Does the DLT Asset have a maturity at issuance less than 397 days? **[YES]**;

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - ii. Is DLT asset used to initiate / conclude a transaction to buy goods/ services as agreed between two or more parties and accordingly functions as a means of payment/ medium of exchange i.e. acts as an instrument of payment? **[NO]**

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is DLT Asset negotiable or capable of being traded on the capital market? **[YES]**

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - iv. Does the DLT asset qualify as a derivative **[NO]**
  - v. Can the value of the DLT Asset be accurately determined at any point in time **[YES]**

# The FI Test – Fin. Instr. (MMI)

- MFSA Guidance Note looks at the following attributes:
  - vi. Does the DLT Asset exhibit any of the following features **[YES]**:
    1. The DLT asset gives rise to an on or off-balance sheet obligation towards the issuer;
    2. Entry in the register of debenture holders

# The FI Test – Fin. Instr. (CIS)

## **C. Collective Investment Schemes**

- Focus on (A) Purpose and (B) Arrangement/Structure.
- Structures that pursue a commercial or industrial activity should not be deemed to be undertaking “collective investment of capital”

# The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - i. Does the DLT Asset qualify as (A) a unit in a scheme or arrangement which has as its object or as one of its objects the collective investment of capital and (B) where the capital is raised through offer of DLT assets for subscription, sale or exchange from one or more investor **[YES]**

# The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT Asset exhibit any of the following features **[YES]**:
    1. The contributions of the participants and the profits or income out of which payments are to be made to them are pooled;



# The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT Asset exhibit any of the following features **[YES]**:
    - 2. Units are or are to be repurchased or redeemed out of the assets of the scheme or arrangement, continuously or in blocks at short intervals at the request of the holders;

# The FI Test – Fin. Instr. (CIS)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT Asset exhibit any of the following features **[YES]**:
    - 3. Units are, or have been, or will be issued continuously or in blocks at short intervals

# The FI Test – Fin. Instr. (FDIs)

## **D. Financial Derivative Instruments**

- Focus on (A) Contract Type, (B) Underlying and (C) Settlement terms and in some instances (D) Purpose.
- Main categories: options, futures, forwards, swaps and CFDs.

# The FI Test – Fin. Instr. (FDIs)

- FDI test is based on the list of financial instruments under MIFID
- 7 different categories of FDIs – Paras C(4) to C(10) of Section C of Annex 1 to MIFID II

# The FI Test – Fin. Instr. (FDIs)

## **Para C(4):**

- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;

# The FI Test – Fin. Instr. (FDI)

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT Asset an option, future, forward rate agreement, swap or other financial derivative instrument? **[YES]**

# The FI Test – Fin. Instr. (FDI)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on one of the following underlying assets: securities, currencies, interest rates or yields, emission allowances, other derivative instruments, financial indices or financial measure? **[YES]**

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is the DLT Asset settled physically or in cash? **[YES]**



# The FI Test – Fin. Instr. (FDIs)

## **Para C(5) to C(7):**

- C(5): Options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event.

# The FI Test – Fin. Instr. (FDIs)

## **Para C(5) to C(7):**

- C(6): Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled.

# The FI Test – Fin. Instr. (FDIs)

## **Para C(5) to C(7):**

- C(7): Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in point 6 of this Section and not being for commercial purposes, which have the characteristics of other derivative financial instruments;

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT Asset an option, future, forward rate agreement, swap or other financial derivative instrument? **[YES]**

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset: commodities?  
**[YES]**

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is the DLT Asset settled in one of the following manners:  
**[YES]**
    - 1. settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is the DLT Asset settled in one of the following manners:  
**[YES]**
    - 2. physically settled provided that they are traded on a regulated market, MTF or an OTF, except for wholesale energy products traded on an OTF, that must be physically settled

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Is the DLT Asset settled in one of the following manners:  
**[YES]**
    - 3. physically settled and not having the features of (2) above (previous slide) and have the characteristics of Other Derivative Financial Instruments



# The FI Test – Fin. Instr. (FDIs)

## **Para C(8):**

- Derivative instruments for the transfer of credit risk

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attribute:
  - i. Is the DLT Asset designed and/or used for the sole purposes of and/or result in the transferring of credit risk from one party to another **[YES]**

# The FI Test – Fin. Instr. (FDIs)

## **Para C(9):**

- Financial contracts for differences.

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attribute:
  - i. Is the DLT Asset termed as a CfD or give the holder an economic exposure, which can be long or short, to (i) the difference between the price of an underlying asset at the start of the contract and the price when the contract is closed or (ii) the difference in the price of two different underlying assets? **[YES]**

# The FI Test – Fin. Instr. (FDIs)

## **Para C(10):**

- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event,...

# The FI Test – Fin. Instr. (FDIs)

## **Para C(10):**

- ...as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT Asset an option, future, forward rate agreement, swap or other financial derivative instrument? **[YES]**

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    1. climatic variables
    2. freight rates or inflation rates
    3. other official economic statistics
    4. telecommunications bandwidth



# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    - 5. commodity storage capacity
    - 6. transmission or transportation capacity relating to commodities, whether cable, pipeline or other means

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    - 7. an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    - 8. a geological, environmental or other physical variable

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    - 9. any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    - 10. an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - ii. Does the DLT asset give rise to an economic exposure based on the following underlying asset
    - 11. any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Does the DLT Asset satisfy one of the following criteria:  
**[YES]**
    1. settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event

# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Does the DLT Asset satisfy one of the following criteria:  
**[YES]**
    - 2. be traded on a regulated market, a MTF, an OTF, or a third country trading venue that performs a similar function to a regulated market, MTF or an OTF?



# The FI Test – Fin. Instr. (FDIs)

- MFSA Guidance Note looks at the following attributes:
  - iii. Does the DLT Asset satisfy one of the following criteria:  
**[YES]**
    - 3. have the characteristics of Other Derivative Financial Instruments

# The FI Test – Emissions Allow.

## **E. Emissions Allowances**

- Focus on (A) Issuer, (B) Manner in which it is issued

# The FI Test – Emissions Allow.

- MFSA Guidance Note looks at the following attributes:
  - i. Is the DLT Asset issued by the national competent authority in terms of Directive 2003/87/EC for the purposes of Directive 2003/87/EC **[YES]**.

# Concluding Remarks

- Guidance note gives direction and if correctly applied certainty
- VFA Service providers should carry out test on all DLT assets they deal in
- Assessment can be complicated
- Watch out for definition of security and CIS

# Thank you.

**James Farrugia**

[jfarrugia@ganadoadvocates.com](mailto:jfarrugia@ganadoadvocates.com)

[www.ganadoadvocates.com](http://www.ganadoadvocates.com)



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