

BVI Hedge Fund Services 2018



BVI prepares for the FinTech Revolution

Approved and Incubator Funds prove attractive

Holistic services approach draws new funds

In this issue...

03 BVI expects crypto assets to provide growth tailwind

By James Williams

10 Pre-launch and post-launch support for fund managers

Interview with Peter Jakubicka, Circle Partners

12 The British Virgin Islands' fintech revolution

By Phillip Graham, Harneys

14 BVI to take 'Goldilocks' approach for regulating crypto assets

Interview with Michael Killourhy, Ogier



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BVI expects crypto assets to provide growth tailwind

By James Williams

When Hurricane Irma, a Category 5 storm, struck the BVI on Wednesday, 6th September 2017, it had a devastating impact, wiping out critical infrastructure and denying inhabitants any electricity supplies for six months. It was a moment of collective grief, but the BVI's resilience and collective spirit shone through. In short, its response was as strong and as focused as the storm that bore down that day.

Incredibly, despite the carnage, there was very little business disruption.

As Simon Schilder, Partner at Ogier who once lived in the BVI but is now based in Jersey, recalls: "Our disaster recovery plan worked very well and by an incredible feat the BVI registry was up and running within 48 hours. The BVI court registry relocated down to St Lucia for six months, so there really was very little business disruption, despite the fact that at a personal level, the hurricane was very disruptive for the BVI's inhabitants.

"I was in the BVI six months after the

hurricane, and the electricity had only just been switched on across the island. The government actually moved in to some of our offices because the government building was very badly hit. There was a real pulling together among the service provider community, sharing office space and supporting one another.

“At Ogier, we were up and running by the Sunday evening, using the Jersey server and were operating as business as usual. Our DRP will learn lessons from Hurricane Irma in the same way that we learned lessons from Hurricane Ivan in 2004, which hit the Cayman Islands.”

Before delving in to ‘crypto world’, it is worth pointing out that to continue its evolution as a leading offshore funds jurisdiction, the BVI is making several amendments to its legislative framework.

One of these amendments relates to the BVI Partnership Act, 1996, which many of the islands’ practitioners agree is well overdue an update. This should open up some new opportunities for the BVI, in particular on the PE and VC side. One of the key benefits to the updated BVI Partnership Act will be the ability to create LPs with separate legal personality.

Glenford Malone is Director, Investment Business Division, BVI Financial Services Commission. He believes the BVI funds industry continues to show resilience and demonstrate its attractiveness with increased product offerings.

“With the advent of new products such as Approved Funds and Incubator Funds, there continues to be interest in utilising BVI funds from new market entrants and those who customarily use the BVI. BVI continues to see growth in assets under management in the funds industry.”

Too many people assume that in order to successfully raise capital they should establish a Cayman vehicle. There are no requirements for BVI funds to have all their service providers located on the island. A manager can have exactly the same service providers as they would for a Cayman fund. A lot of BVI funds are still serviced by fund administrators based in Bermuda, or Dublin.

By choosing the BVI, managers need not worry that they are somehow disadvantaging themselves.



“Our disaster recovery plan worked very well and by an incredible feat the BVI registry was up and running within 48 hours.”

Simon Schilder, Ogier

“A lot of new managers think by not choosing the Cayman Islands they are somehow missing a trick. I’ve honestly never seen a manager not raise capital because they have a BVI vehicle as opposed to a Cayman vehicle. In the worst case, it is an additional due diligence question to answer,” says Schilder.

Crypto trends & insights

As the BVI looks ahead, it is encouraged by the tailwinds offered by crypto assets and the associated growing interest in Initial Coin Offerings (ICOs). These new developments, which other jurisdictions such as the Cayman Islands, Bermuda – and Switzerland in an onshore context – are closely analysing to understand the commercial benefits, represent a new frontier for the BVI. And a way to build on the huge success of the BVI registered company, which has been favoured by financial professionals for years, if not decades.

“The jurisdiction looks to update legislation where it needs to meet market demand but the core legislation still operates the way we want it to, with respect to BVI registered companies, providing great flexibility and certainty,” says Phillip Graham, Partner at Harneys. In his view, this augurs well for the BVI when it comes to entrepreneurs wishing to launch an ICO.

“In an ICO context, there is no doubt that allows us to provide for creative structuring suggestions based on the level of flexibility and comfort that people have. Our commercial court is very good. If something were to go wrong, people know they have the protection of not only the commercial court in the BVI but fundamentally English law protection in the event of an appeal going to the privy council.”

Graham confirms that during a recent

investment funds association meeting that he chaired, half the conversation centred on crypto assets and ICOs. As alluded to above, there is still an inherent bias towards the Cayman Islands in traditional hedge and PE terms.

But the reality of the crypto world, and in particular the ICO world, is that the type of person launching these entities is not your traditional fund manager; although some institutional fund managers are now getting involved.

As such, these entrepreneurs don't have the same jurisdictional bias that a fund manager might have. This has been interesting for the BVI as a result.

"Crypto fund inquiries are not far off accounting for 50 per cent of all the new inquiries we receive at the moment, which is quite an incredible share for this niche sector. Anecdotally, we see clients electing to launch crypto-focused funds in the BVI on an equal basis with Cayman, and that ratio is very healthy for the BVI compared to the norm," comments Graham.

"Service providers really want to capture this growth and what is exciting is that the BVI's financial regulator, the Financial Services Commission (FSC) is open to the concept. They will always adopt the usual regulator stance in terms of making sure that the reputation of the jurisdiction is protected but they also want to understand how this new asset class might benefit the BVI, what it should look like and how it should work."

With a typical hedge fund application one would detail who the custodian is, but that is not the case for many of these crypto asset funds. There are still fundamental gaps, or areas of improvement, that need to be addressed.

The first, related to AML, is critical. This could be relatively straightforward if it is a crypto fund accepting fiat currency, which the fund converts into cryptocurrency. However, a lot of managers want investors to invest in their cryptocurrency using digital wallets. That creates AML issues. Service providers are coming to market with interesting analytical tools for digital wallets, which is good to see, but more work is needed to improve the AML framework, for regulators like the FSC to get comfortable.



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Phillip Graham, Harneys

Custody is the second area, in relation to how funds hold the crypto assets.

"The third area relates to the brokerage function; one that allows people and funds to access different exchanges to buy cryptocurrencies, which up until now has proven quite clunky, operationally speaking. It was quite hard for crypto funds to buy and sell cryptocurrencies but people are bringing in new brokerage functions to access cryptocurrencies across multiple exchanges at any one time and to help managers assess best-in-class options to execute transactions. That space is now evolving and helping improve the way crypto funds operate," explains Graham.

FSC focusing on disclosure requirements

The BVI's product offering of various types of funds such as private, professional and public funds can cater to diversified markets and asset types. These products historically have, and continue to offer, necessary investor protections that are important with the emerging asset classes.

Over the course of the past year, Malone says that the FSC has approved a number of funds who invest directly into the fintech and crypto asset space "and we see increased use of BVI products in these areas".

"In approving these funds," says Malone, "we have paid particular attention to disclosure requirements and the protection of investors. Our focus was primarily as it relates to ensuring appropriate custody arrangements for assets and adequate AML/CFT measures are in place. We continue to monitor the fintech space, particularly as it relates to developments such as crypto currencies, distributed ledger technology

and ICOs. Over the course of the next few months we expect to issue industry guidance and to introduce a Regulatory Sandbox which will be geared towards monitoring innovation at the earliest stage.”

Schilder confirms that crypto is very much the asset class ‘in vogue’ at the moment, both in the BVI and the Cayman Islands, confirming that a large majority of new proposal work is coming from managers wishing to launch cryptocurrency funds.

“One of the main observations is that by and large a lot of crypto funds are being structured as Approved Managers with Incubator Funds; that’s been the typical model so far, even though the actual fund launches are not significant in terms of AUM,” says Schilder. “One crypto manager that we helped launch their fund last year has already converted his Incubator Fund into a Professional Fund.

“Another client of ours has converted into a Professional Fund but they also have a limited number of investor capital pools for a separate strategy. I suggested putting those investors into an Approved Fund, which is limited to 20 investors but unlike the Incubator Fund, there is no two-year time limit.”

He adds that for a manager spinning out of a big shop with a big ticket, the best option would be to use the Approved Manager with the BVI Professional Fund.

To briefly clarify, the Approved Fund can effectively be thought of as a BVI private fund with guaranteed exemptions. At the FSC, Malone confirms that the Approved Manager regime continues to be well received by the private sector.

Approved managers are widely being utilised by new startup fund managers to test specific ideas and to quickly enter the market place, with Malone commenting: “Statistical returns indicate that the assets under management of approved managers continue to rise. The success of the product is also buttressed by the fact that we have seen a number of entities approach and surpass the maximum assets under management of USD400 million. These managers have been able to transition up to a full investment business licensee given their success.”

The emergence of crypto assets has been



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Glenford Malone, BVI FSC

welcome news for the BVI’s service provider community, including fund administrators such as Circle Partners. Peter Jakubicka, Business Development Manager, confirms that Circle has helped a few clients launch crypto funds this year and while he broadly agrees that these products are flavour of the month, he warns that launching one of these strategies is not necessarily straightforward.

“We work closely with clients to set up the structure but once it comes to opening accounts with crypto exchanges it can be a very long and difficult process. I’ve seen funds get the green light in January and by December they’ve still not gone live.

“It’s something that people need to take into account because while the legal part is relatively straightforward, everything else is challenging – in general it’s still a new asset class and investors are still quite hesitant to accept these strategies,” says Jakubicka.

For the banks, their biggest worry is that they cannot track and trace the source of money in certain situations; this goes back to the AML issue raised earlier.

“They are being careful not to accept funds where subscriptions in kind are possible; we too do not allow this, unlike other fund administrators. We would only support crypto funds that accept subscriptions in fiat currencies.

“We are careful but we are open to accept almost all sorts of crypto strategies. We do require the fund to appoint an auditor, however, a legal counsel and other



requirements that need to be satisfied. We would not support strategies that use OTC exchanges yet," clarifies Jakubicka.

ICOs and SIBA regulation

There are numerous reasons for why entrepreneurs, as well as fund managers, might wish to avail of the BVI's jurisdictional expertise from where to launch ICOs. Perhaps one of the most important reasons is that the BVI provides a modern legislative framework for those intending to set up new companies and engage in innovative activities.

"The attractiveness of the regime is that it provides a strong legal framework with the right level of regulation and supervision that encourages innovation," comments Malone.

Under SIBA regulation, a person is prohibited from carrying on, or holding themselves out as carrying on, investment business of any kind in or from within the BVI, unless that person holds a licence from the FSC, or is within one of the exemptions or safe harbours offered by SIBA.

However, an ICO that issues standard utility tokens should not be subject to the general prohibition, as utility tokens would not come within the definition of an "investment" for the purposes of SIBA.

Michael Killourhy is Partner at Ogier (BVI). He explains that while in many cases the tokens that are the subject of ICO issues would not fall within the scope of SIBA, certain forms of token or crypto asset might well come within the definition of investment if their value or return is determined by reference to the performance of some other asset or business (such that it becomes a form of derivative).

Therefore the terms of any proposed token or crypto asset should be carefully considered.

In discussing the ICO and crypto trend, Killourhy says: "We are always very careful to confirm the background and true intent of any potential new clients. Everyone has to go through a robust onboarding process. While the jurisdiction as a whole is certainly keen to encourage responsible entrepreneurs in the fintech space who see the BVI as an advantageous jurisdiction, and very much wants to be part of new technology and a new way of doing things, neither we nor the BVI wish to be involved in anything that could potentially harm the BVI's reputation.

"The approach being taken is a cautious one but at the same time we don't want to throw the baby out with the bath water. If

there is some value to the BVI, which could offer new streams of business, it should be something that the FSC cautiously encourages. What is needed is a legal framework that allows us to look at this emerging asset class in a more considered, structured way; which will be of benefit to both the BVI and clients alike.”

Killourhy sees entrepreneurs as well as some established businesses getting involved with ICOs, with coders and engineers presenting a new category of client for the BVI's service provider community. Typically, these are millennials coming up with novel ideas where they look to use a token issue via an ICO to support another blockchain initiative, which could be anything from combined social media applications for organising, booking paying for and reviewing an evening or day out, through to platform-based solutions for the registration of land and other property transfers.

What could this potentially mean for the BVI, going forward?

Killourhy responds: “I think that it will drive the regulatory debate and I suspect there may be something in the pipeline towards the end of the year; certainly in the next 12 months. And it maybe something in the area of sandbox arrangements for new fintech businesses that may trip into existing regulations. I am very optimistic that the regulation, when it does arrive, will take a carefully constructive approach to the space, clarifying rules and encouraging the



“I am very optimistic that the regulation, when it does arrive, will take a carefully constructive approach to the space, clarifying rules and encouraging the responsible players while protecting against abuse and reputational harm to the BVI.”

Michael Killourhy, Ogier

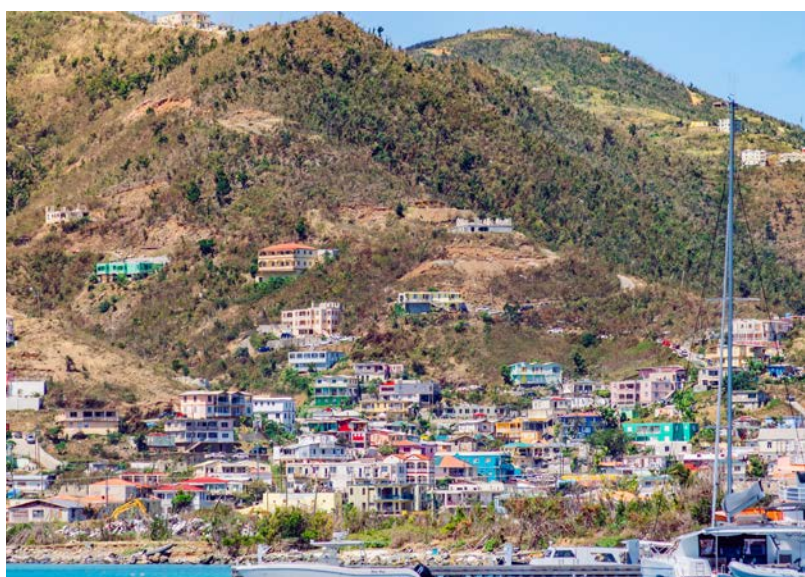
responsible players while protecting against abuse and reputational harm to the BVI.”

At the moment, regulators are looking at the issuance of tokens and how they should be categorised. “All of our legislations are quite prescriptive, what gets caught as an investment business is predicated on a list of 10 criteria. Unlike in the US, where a security is more conceptual, in offshore jurisdictions a security is one of ten things, and I think that list will become 11 to cover ICOs and the issuance of tokens,” opines Schilder.

Graham notes that the FSC is keen to get its arms around this new asset class and says it's quite interesting to watch other jurisdictions moving at different speeds and directions as they determine what their appropriate level of risk appetite is.

“Some are shutting this world out completely, some are fully embracing it while others are somewhere in the middle; and I would include the BVI in that context. We want to encourage and embrace this new world of ICOs, digital exchanges and smart contracts, but at all times ensure the jurisdiction also provides an appropriate layer of regulation. The consultation that is going on at the moment gives me a great deal of encouragement,” he says.

The next 12 months should be an exciting period for the BVI. If it achieves the right level of regulation and imposes sensible ICO guidelines – one only has to look at Switzerland in this respect (check out our recent **Swiss Crypto Innovation** report) – the jurisdiction could go from strength to strength. And the devastation of Hurricane Irma will be replaced by the uplifting tailwinds of all things crypto. ■





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Pre-launch and post-launch support for fund managers

Interview with Peter Jakubicka

The BVI remains an attractive option to US and Asia Pacific fund managers thanks, in large part, to new structures such as the Approved Fund and Incubator Fund, according to Peter Jakubicka, Business Development Manager at Circle Partners.

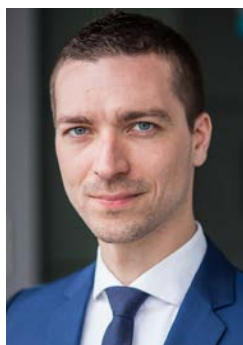
Circle Partners ('Circle') is an independent fund administrator with offices across the EU, the Americas and Asia and is able to guide start-up managers through the whole process of bringing a new fund to market in all major fund jurisdictions.

"At the pre-launch phase," says Jakubicka, "we give clients good advice on how to set up a legal structure in the BVI, and what we offer is effectively a turn-key solution. We go through every aspect of setting up the structure and we also have a sister company in the BVI that provides registered office and other ancillary incorporation services and also work closely with other counterparties throughout the set-up process."

At the post-launch phase, Circle provides ongoing administration services and investor services. It also provides numerous reporting services in response to today's heavily regulated environment; these include FATCA, CRS, Solvency II as well as reporting locally in the BVI.

Jakubicka notes that Circle can also help advise clients wishing to set up their own management companies in the BVI.

"The Approved Manager regime is a very good product. If you use this in combination with an Approved Fund you've got a full fund structure with limited costs as well as limited supervision and regulation imposed. This can help start-ups and emerging managers build up a track record without needing to bear a lot of costs from day one.



Peter Jakubicka, Business Development Manager at Circle Partners

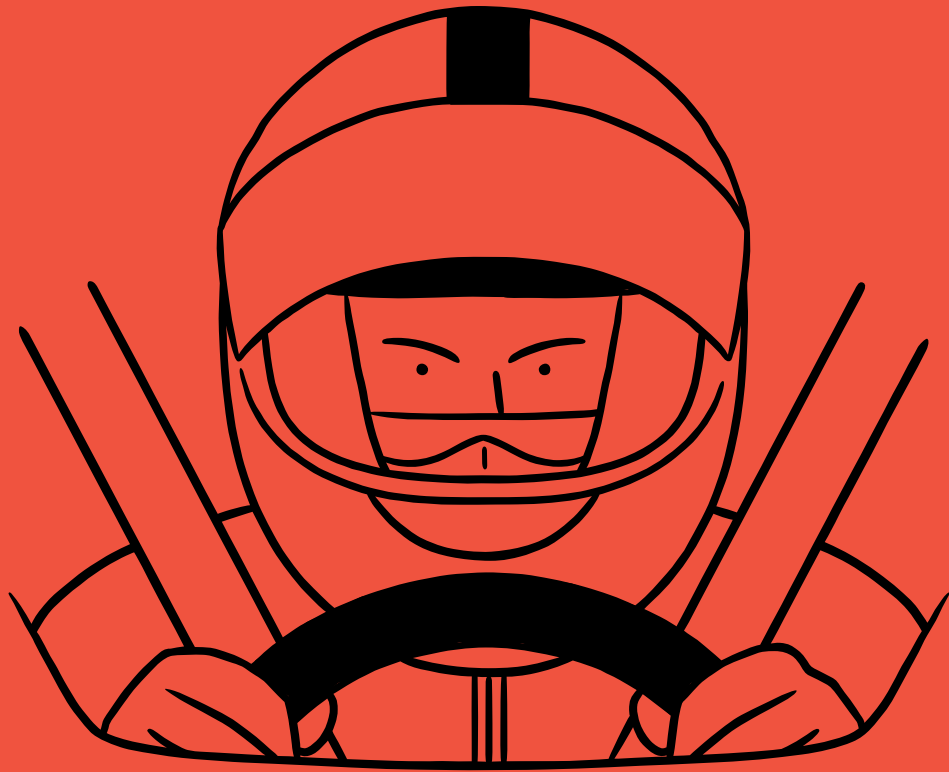
Once their AUM has grown to a good level, managers then have the option to transfer into a professional BVI fund structure, or even re-domicile to other jurisdictions," outlines Jakubicka.

Jakubicka explains that the vast majority of Circle's clients opt to use the Approved Fund compared to the Incubator Fund. There are two limitations to the Incubator Fund: first of all, it can have no more than 20 investors and no more than USD20 million in AUM. Then, after two years, one has to switch it to a BVI Professional Fund.

"The only difference with using an Approved Fund is that you have to appoint an administrator, but people would have to end up doing this anyway after transferring their Incubator Fund and to be able to open bank and brokerage accounts. People generally prefer the Approved Fund as a result but it depends on the individual client and their strategy. There aren't many other service providers beyond the fund administrator that you need to appoint to these structures," says Jakubicka.

On average, Jakubicka says it takes three to four weeks to finalise the legal documentation (incorporations, drafting the fund prospectus, appointing all parties to the fund).

"Once that is in place, you can start opening brokerage and bank accounts, which takes another three to four weeks. If it is a counterparty that is not known or used to working with investment funds then it can take longer. We can help clients with the Approved Manager set-up simultaneously with the Approved Fund set-up," concludes Jakubicka. ■



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HARNEYS

The British Virgin Islands' fintech revolution

By Phillip Graham

The BVI is reportedly the second biggest cryptocurrency market in the world, according to statistics published by CoinShares, which used data collected from the 15 biggest cryptocurrency exchanges and concluded that the BVI had a trading volume in crypto assets valued at USD78.5 billion, in the first six months of 2018. This puts it just USD5.3 billion behind the USA. We also noted in a recent PwC report that two of the three largest Initial Coin Offerings (ICOs) have also been domiciled in the BVI.

These startling statistics come as no surprise to those of us at Harneys who have been at the coal-face of the crypto buzz for a number of years now and have seen quite incredible activity in this area, which includes not only ICOs and cryptocurrency exchanges, but also a high volume of investment fund launches which are solely focused on this unique asset class.

The opportunity for the jurisdiction to be one of the pioneers in this space has not been lost by both the public and private sector alike and with a combination of joint initiatives and forums, the laws and regulations in the BVI are adapting to ensure



Phillip Graham, Partner at Harneys

that this area is lightly but appropriately regulated to meet the overwhelming demand of the global client base.

We have already seen in June of this year, the launch of the micro business company or MBC. Aimed at small, non-financial sector businesses anywhere in the world, MBCs will be simpler to set up and operate, with lower registration and annual fees. One of the key aspects is that MBCs will be able to be formed and accessed through a smartphone, with AML checks being done via an app connecting to the Regulator's IT platform.

On top of that, we have also seen an amended AML Code of Practice this summer, which allow operators carrying out BVI AML checks to use the latest electronic innovations to improve and speed up KYC processes, including the approval of a digital verification system.

We have already had the new Limited Partnership Act, 2017, which came into force at the start of the year and provided a ground-breaking new limited partnership structure, drawing on best practice for these structures from around the world and we will very shortly have a huge expansion on the use of segregated portfolio companies, to provide an unregulated and flexible solution to meet the requirements of clients who are seeing innovative new ways to operate SPCs.

Harneys has worked tirelessly on all of these initiatives and we are delighted that the jurisdiction has been able to move so positively despite the challenges that Hurricane Irma brought on last year. It is a true testament to both the resilience and forward thinking nature of these islands.

With hotly anticipated legislation expected in the ICO and digital asset exchange areas, as well as potentially the introduction of a Regulatory Sandbox in the BVI, we anticipate that the BVI's fintech movement will only continue to go from strength to strength. ■



Innovative

Let's get to the point: we understand funds. Ogier's specialists have been at the forefront of fund set-up, structuring and finance since the inception of the industry with many actively involved in drafting the key laws that underpin fund structures across our international jurisdictions. We act for banks, financial institutions, funds and promoters, working with blue chip clients with established track records and the most innovative and entrepreneurial new sponsors entering the market. We pride ourselves on providing responsive and practical advice, while our hands-on, partner-led teams ensure a consistent approach.

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BVI to take ‘Goldilocks’ approach for regulating crypto assets

Interview with Michael Killourhy

“I would say every day I get two or three inquiries on some crypto or blockchain-related project. There is a lot of interest in all things crypto here in the BVI,” observes Michael Killourhy, Partner at Ogier (BVI).

Such is the level of interest that earlier this year, Killourhy noted in a briefing that the BVI was keen to investigate a role in this new capital raising phenomena, which, it is believed, raised an estimated **USD3.5 billion in ICOs around the world during 2017**.

According to **Cryptobriefing**, over the first six months of 2018 the BVI saw USD78.5 billion of trading volume in crypto assets, putting it in second place behind the US, which, with USD83.8 billion is the world’s largest cryptocurrency market.

“We have looked at various structures and we regularly get asked to give guidance and memoranda of advice on whether a token is an investment? Is it a security? What is it, in respect to the BVI? A lot of people are showing interest in using the BVI to set up issuer vehicles,” confirms Killourhy.

Crypto assets have dominated investor and manager interest over the last couple of years as more awareness of the potential of blockchain technology builds. At the end of 2017, Nick Rogers heads the Cayman Digital, Blockchain and Fintech Group at Ogier in the Cayman Islands, featured in the **Hedgeweek Cayman Islands Special Report**.

Rogers confirmed that Ogier have developed specialist understanding of the particular issues that arise including around custody, intra-day dealing, valuation and regulatory and compliance issues.

“At this stage in the evolution of cryptocurrencies,” he said “there are still quite a few barriers to entry – e.g. regulatory treatment, limitations on short selling,



Michael Killourhy, Partner at Ogier (BVI)

volatility, technical complexity – but even if the ICO market cools it seems clear that blockchain applications and digital currencies offer the key to future financial innovation.”

In some respects, offshore financial centres still have to tread carefully in terms of how they strike the right balance of imposing regulatory guidelines while still appearing attractive to entrepreneurs.

“On the one side the BVI is keen to explore what the value of crypto and other blockchain applications are and how we can use what we have, in terms of the success of the BVI company and the legislation we have here to enter into a new technology world. But equally, we don’t want to find ourselves associated with any business or scheme that might have negative effects in the wider world and damage the reputation of the BVI by association. It is a tricky sphere at the moment and the jurisdiction generally, as well as law firms like Ogier have to be extremely careful,” says Killourhy.

“Currently, there isn’t any specific legislation dealing with cryptocurrencies or ICOs but the BVI may change that at some point. The Territory is looking at what other jurisdictions are doing (including Bermuda) in order to get the right level of regulation and encourage entrepreneurs.

“Getting the right regulation that provides protection and safeguards against AML and other issues is important. It’s good marketing for a jurisdiction to demonstrate that it knows about crypto and can confidently say, ‘Here is the regulatory regime we’ve put in place to oversee it and to uphold our reputation’,” concludes Killourhy.

For the BVI, it could be a case of adopting a regulatory Goldilocks model. ■