George Johnson Law Prize 2020

Topic 4: "*What reforms to Manx substantive law or procedure are necessary in order to make the Isle of Man more competitive as an offshore financial centre*"?

1. Introduction

1.1 This essay identifies three possible reforms (the first of which is procedural in nature, and the second and third which relate to substantive law) which would, it is argued, make the Isle of Man more competitive as an offshore financial centre. In no particular order of preference or importance, these reforms are:

a) The extension of the concept of 'permission to appeal' in civil court proceedings;

b) Clear and specific regulation of persons involved with digital assets (especially so-called 'security tokens'); and

c) An amendment to the Proceeds of Crime Act 2008 ("**POCA**") to provide more permissive regulation of medicinal cannabis and funds derived from it.

1.2 In order to assess the competitive advantages the Isle of Man might gain from implementing these changes, it is necessary to include a comparative analysis of the legal position in some other jurisdictions.

2. The first possible reform – the extension of the concept of 'permission to appeal' in civil proceedings

2.1 Part 14 of the Rules of the High Court of Justice 2009 (the "**Rules**") deals with appeals from Orders made in the Civil Division of the High Court of Justice (the "**Court**"). Rule 14.4 states:

> ***"14.4 Second appeals to the court***
>
> *(1) Permission is required from the Appeal Division for any appeal to that Division from a decision of the Civil Division which was itself made on appeal.*
>
> *(2) The Appeal Division shall not give permission unless it considers that —*
>
> *(a) the appeal would raise an important point of principle or practice; or*
>
> *(b) there is some other compelling reason for the Appeal Division to hear it".*

2.2 Rule 14.4 makes clear that the only circumstance in which a litigant is required to obtain the Appeal Division's permission to bring an appeal is where the Order being appealed was itself made on appeal. Litigants wishing to appeal Orders made at first instance in the Civil Division (whether final Orders or interlocutory Orders) do not require permission from the Appeal Division (except in relation to costs Orders, as discussed in paragraph 2.12 below). This can lead to multiple appeals in the same set of proceedings, which is undesirable and delays access to justice for other litigants.

2.3 The Court has a busy caseload. Court time is precious and as a small jurisdiction the Island naturally has a limited number of judicial officers able to hear and determine legal proceedings, particularly in the Appeal Division. There have been frequent judicial pronouncements referring to the fact that Court time, and judicial resources, are limited. In *Howell v DHSS* (one of the first cases to be decided after the coming into force of the Rules) Deemster Doyle stated[1]:

> "*The public interest in the efficient use of court resources is a relevant consideration in the exercise of judicial discretions to permit amendments and adjournments. The waste of public resources and undue delay should be taken into account in the exercise of judicial discretions.*"

2.4 Although these remarks were made in the context of applications to amend pleadings and adjourn trial dates, it is submitted that they are equally applicable to the conduct of civil litigation on the Isle of Man more generally.

2.5 More recently In the *Isis Investments* case Deemster Doyle stated[2]:

> *"Deemster Moran in the Bitel LLC case (ORD 11/0048 judgment 4th May 2012) referred at paragraph 81 to the "modern litigation environment" and the need for "a cost benefit analysis" and to consider whether the process involves "a proper use of Manx judicial resources".*

2.6 The fact that there is presently no 'permission to appeal' stage for appeals against first-instance Orders made in the Civil Division has resulted in a large number of cases in which the Appeal Division has had to deal with unmeritorious appeals, sometimes by dissatisfied litigants who pursue multiple appeals on either the same issue or very similar issues. This takes up valuable court time and resources and it inevitably means that other litigants must wait longer before their cases are heard.

2.7 By way of example, the long-running litigation between Lloyds Bank International Limited (formerly Lloyds TSB) (hereafter referred to as the "**Bank**") and Samuel George Alder and others (hereafter referred to as the "**Slegaby Parties**"), resulted in multiple interlocutory and substantive appeals by various of the Slegaby Parties against Orders made at first instance[3]. Each of these appeals was unsuccessful on virtually every ground. The history of the litigation is too lengthy to recite in detail in this essay, but the following extracts from some of the judgments demonstrate why a permission to appeal stage would have been beneficial to the Appeal Division in this litigation since it would appear that if permission to appeal had been required, the Slegaby Parties would have struggled to overcome that barrier.

2.8 The dispute was initially concerned with funds that the Slegaby Parties had borrowed from the Bank in order to finance a building project, but the Slegaby Parties failed to repay those funds on time. When the Bank issued proceedings for the money, the Slegaby Parties defended the claim, and one of their grounds for doing so was that the Bank had been guilty of 'imprudent lending' because it knew that the borrowing entity would not be able to

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[1] ORD 2009/24; paragraph 7.
[2] CHP 2012/1; paragraph 41.
[3] There were also numerous unsuccessful appeals to the Privy Council against Orders made by the Appeal Division and numerous unsuccessful applications to the Appeal Division for various members of that Division to recuse themselves from particular hearings.

repay the funds if the project was unsuccessful. The 'imprudent lending' defence was rejected at first instance by High Bailiff Needham, and also on appeal. The Court expressed the view in a number of separate judgments that some of the arguments advanced by the Slegaby Parties had little prospect of success. For example in the original appeal the Appeal Division stated[4]:

> "...*we are satisfied that the High Bailiff did not err by denying the Appellants the opportunity to adduce evidence in respect of a submission which he, and we, are satisfied was bound to fail.*"

2.9 After a significant number of interlocutory and substantive appeals by the Slegaby Parties on various matters, the Bank issued bankruptcy proceedings against Mr. Alder. The bankruptcy claim succeeded at first instance, but was appealed. In its judgment on the appeal, the Appeal Division stated[5]:

> "*We have concluded that Mr Alder's appeal is totally without merit*".

2.10 The Slegaby/Lloyds Bank litigation is not the only dispute which could potentially have taken up far less Court time had there been a 'permission to appeal' stage. In *Holmes v Carters* the Appeal Division stated[6]:

> "*We indicate at the outset that we are totally unpersuaded by the Appellant's arguments. There is nothing in this appeal and we dismiss it without hesitation for the reasons that follow.*"...

2.11 Later in its judgment the Appeal Division held:[7]

> "*It follows, for the reasons specified above, that this appeal is dismissed as being totally without merit, but we do not consider it appropriate to make a civil restraint order at this stage*".

2.12 The introduction of a 'permission to appeal' stage would also assist in the context of doleance claims because it would mean that the respondents to such claims would not have to resort to making applications for strike-out or summary judgment, as is currently the case[8]. It is worth noting that permission to appeal is required in respect of costs Orders, and in the recent *Hillberry Trust*[9] case the Appeal Division refused to grant permission to appeal, which if nothing else will almost certainly have saved Court time as well as professional costs for the parties concerned.

2.13 It is submitted that the introduction of a permission to appeal stage for all appeals from the Civil Division of the Court would help to ensure that valuable Court time and resources are made available for the most meritorious cases. Permission could even be granted on a limited basis, in relation to particular grounds of appeal only, which would narrow the scope of the issues in dispute and would further the overriding objective. The Court does of course

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[4] *Re Slegaby Estate and others* (2DS 2013/19); paragraph 51.
[5] *Alder v Lloyds Bank* (2DS 2017/9); paragraph 114.
[6] (2DS 2018/4); paragraph 2.
[7] Ibid.; paragraph 63.
[8] See for example *Kniveton v Public Services Commission and other* (CHP 2018/0018).
[9] *Hilberry Trust Company v Douglas Trustees and others* (2DS 2020/06).

have the option of making a civil restraint order against persistent litigants, but there is a very high bar to such orders and they are very rarely granted in practice[10].

England and Wales

2.14 In England and Wales, a party wishing to appeal an Order of the County Court to the High Court, or an Order of the High Court to the Court of Appeal, must obtain permission to appeal in all but some very limited circumstances[11]. When considering whether to grant permission to appeal, the relevant court must consider the following tests:

a) Where the appeal is a first appeal, CPR 52.6 provides that the appellant must demonstrate a '*real prospect of success, or some other compelling reason;*' and

b) Where the appeal is a second appeal, CPR 52.7 provides that in addition to demonstrating that the appeal has a real prospect of success, the appellant must also show that the appeal raises "*an important point of principle or practice or some other compelling reason*".

2.15 This threshold test would have been even higher had the Civil Procedure Rule Committee ("**CPRC**") implemented a change, mooted in 2016, which would have replaced the '*real prospect of success*' test with a '*substantial prospect of success*' analysis. Ultimately this reform did not proceed, but the minutes of a meeting of the CPRC held on 3 February 2017 revealed that although the availability of historic appeal data was poor, for the period between 2012 and 2015 the average success rate in cases where the Court of Appeal had granted permission to appeal was 25%-26%, against an overall success rate of 42% across all civil appeals. Put another way, approximately 74%-75% of cases where the Court of Appeal had granted permission to appeal ultimately failed at the substantive hearing. A note prepared by Lexis Nexis states that the minutes of the CPRC meeting on 3 February 2017 recorded that:[12]

> *"While it is clear that their [sic] is significant judicial appetite for changing the threshold test, with the Master of the Rolls and the Court of Appeal judiciary in favour of change, the CPRC minutes reveal that a lack of clarity regarding the underlying data has proven a stumbling block to progress."*

2.16 The Lexis Nexis note also states (this author's emphasis in bold)[13]:

> "*Significant changes to civil appeals were introduced in 2016 in response to a focused effort to cut the long waiting times in the Court of Appeal, maintain the service provided by the court and* ***ensure the UK remains attractive as a venue for litigation in large commercial cases***."

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[10] The key part of the test is effectively that the litigant must have made a minimum of three unmeritorious claims or applications (see *Adenaike v Department of Home Affairs & another* (2DS 2017/31)).

[11] Such circumstances include committal proceedings, writs of habeas corpus and orders made in respect of secure accommodation under the Children Act 1989.

[12] Lexis Nexis, '*CPRC—latest developments on threshold test for permission to appeal to Court of Appeal*' (4 April 2017): 'https://www.lexisnexis.com/uk/lexispsl/disputeresolution/document/412012/5N7M-D6J1-DYW7-W3D8-00000-00/CPRC%E2%80%94latest-developments-on-threshold-test-for-permission-to-appeal-to-Court-of-Appeal accessed 10 May 2020.

[13] Lexis Nexis note (Ibid.).

2.17 It is submitted that if the Isle of Man were to introduce a 'permission to appeal' stage, this would go some way towards ensuring that the Island remains an attractive venue for commercial litigation because it would enable litigants to have more confidence in the speedy resolution and the finality of civil commercial proceedings.

Jersey

2.18 The test in Jersey is similar to that in England and Wales and is set out in article 13 of the Court of Appeal (Jersey) Law 1961, as supplemented by the decision of the Royal Court of Jersey in the *Crociani* case[14] in which it was held that the test for granting permission to appeal is:

a) the appeal must have a real prospect of success; or

b) there is a question of general principle which falls to be decided for the first time; or

c) there is an important question of law upon which further argument and a decision of the Court of Appeal would be to the public advantage.

2.19 Unfortunately it does not appear that any statistics are available from the Royal Court of Jersey in terms of the number of civil appeals filed and the percentage of those which succeed in that jurisdiction.

The Cayman Islands and the British Virgin Islands

2.20 In the Cayman Islands, as in the Isle of Man, parties have an automatic right of appeal from final Orders made at first instance. The Court of Appeal in the Cayman Islands has dealt with an average of 23 appeals each year since 2008, but no data is available in terms of how many of these appeals were successful[15]. The Cayman Court of Appeal usually sits for three sessions of three weeks each per year[16]. There is also an automatic right of appeal against first-instance decisions made in the British Virgin Islands, pursuant to Rule 62 of the Civil Procedure Rules of the Eastern Caribbean Supreme Court ("**ECSC**"). The ECSC publishes statistics of the number of cases that it finally determines in each calendar quarter, and the percentage of cases which take 24 months or longer to be finally determined frequently exceeds 40% and is sometimes as high as 50%[17].

The Isle of Man

2.21 In the Isle of Man, the Civil Registry Annual Report 2019 reveals that the number of appeals lodged in all cases (not just in civil matters) in each year between 2016 and 2019 was as follows[18]:

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[14] *Crociani and others v Crociani and others* [2014] JCA 089.

[15] Cayman Islands Judicial Administration, '*Judicial and Court Statistics 2018*': https://www.judicial.ky/wp-content/uploads/publications/annual-statistics/JudicialandCourtStatistics2018.pdf accessed 10 May 2020. The highest number of appeals in any given year was 29, and the lowest 16.

[16] Cayman Islands Judicial Administration, '*Court of Appeal*': https://www.judicial.ky/courts/court-of-appeal accessed 10 May 2020.

[17] Eastern Caribbean Supreme Court, '*Appeals Reports*': https://www.eccourts.org/category/appeals-reports/ accessed 10 May 2020.

[18] General Registry Annual Report 2019: https://www.gov.im/media/1367333/general-registry-annual-report-2019-v2.pdf accessed 10 May 2020.

Year	Number of appeals lodged
2016	16
2017	33
2018	17
2019	26

2.22 Although no official statistics are available in terms of either the length of time taken between an appeal being filed and judgment being handed down, or the number of successful appeals, a review of the published judgments on www.judgments.im reveals the following numbers of civil appeals which succeeded (whether in whole or in part) at the substantive hearing stage, compared with those civil appeals which were unsuccessful, for each calendar year[19]:

Year	Number of successful civil appeals	Number of unsuccessful civil appeals
2016	1	4
2017	2	7
2018	1	9
2019	3	6
2020[20]	1	3

2.23 These statistics clearly show an established and continuing trend that the substantial majority of civil appeals are unsuccessful, notwithstanding the fact that the actual number of civil cases lodged in the Appeal Division appears to be comparatively lower than in the equivalent courts in the Cayman Islands and the British Virgin Islands.

2.24 Based upon the above statistics, it could be argued that because the Appeal Division in the Isle of Man hears fewer cases than the appellate courts in comparator jurisdictions with similar rules about permission to appeal, the perceived problem is not as severe as is argued in this essay, especially as appeals in the Isle of Man are almost certainly heard more quickly than in the Caribbean (although no data is available in this respect). Whilst it is true that the number of cases filed in the Appeal Division appears lower than in the Cayman Islands or the British Virgin Islands, the Appeal Division is a busy court and in order to ensure that justice is administered efficiently, it is submitted that the Appeal Division could not easily cope with even a modest increase in the number of cases listed for determination, because of the very nature of its composition in requiring at least one judge other than the Judge of Appeal to hear the case.

[19] The figures given are in relation to substantive appeal hearings only and do not include appeals in relation to: interlocutory matters; family matters or those involving the care of children; costs; applications for stays; applications for permission to appeal to the Privy Council or applications for temporary advocate's licences. It is acknowledged that these cases will not correlate with the cases referred to in the General Registry Annual Report 2019 because that report refers to cases *filed* in a particular year, not cases actually determined.

[20] Figures for 2020 are for the first quarter (January – March) only.

2.25 In summary, it is argued that the judicial process at appellate level in the Isle of Man would be quicker and more beneficial to litigants if a permission to appeal stage were introduced. It is submitted that if a 'real prospect of success' test were to be introduced:

a) this would act as a gateway to ensure that the Appeal Division would only hear those cases in which the appellant could show a real prospect that an error had been made at first instance; and

b) this would not prejudice access to justice in the Isle of Man nor would it deprive deserving litigants of an opportunity to have their appeal heard and determined[21].

2.26 It is clearly important that litigants in person should not be disadvantaged in terms of arguing their case at the permission stage, because litigants in person may not be able to advance their legal arguments as clearly as those litigants who benefit from legal representation. To the extent that this point may be of concern, it is submitted that the Appeal Division is well versed in dealing with unrepresented litigants and is alive to the need to allow such litigants to put their case.

2.27 Returning to the argument made in paragraph 2.17 above, without the introduction of a 'permission to appeal' stage in civil commercial litigation, it is possible that financial institutions may become more reluctant to lend or to engage in commercial transactions in the Isle of Man if they are faced with seemingly endless and costly appeal proceedings when attempting to recover debts which are due and owing. The Court risks being clogged with unnecessary and unmeritorious appeals which would only serve to delay access to justice for others and increase costs for all involved. This is clearly undesirable from the point of view of ensuring that the Island is an attractive forum for civil commercial litigation.

3. The second possible reform – digital assets

Introduction

3.1 The last few years has seen a sharp increase across the globe in the understanding and adoption of digital assets. In particular, the rise in popularity of cryptocurrencies (digital means of exchange which are generated using mathematical cryptography and which function on a distributed ledger or 'blockchain' without requiring oversight from a central authority such as a bank) has given rise to a number of opportunities from a legal and regulatory perspective, as further explained in the following paragraphs. As of March 2020 it is estimated that there are approximately 47 million active cryptocurrency wallets[22] and research in June 2019 by the cybersecurity company Kaspersky identified that approximately 19% of the world's population had purchased some form of cryptocurrency prior to 2019,[23] so it seems fairly certain that these upward trends are going to increase in the future.

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[21] The *Hillberry Trust* case referred to in footnote 9 above demonstrates that permission to appeal is already effective in the context of appeals against costs Orders.

[22] M. Szmigiera, '*Number of Blockchain wallet users worldwide from 3rd quarter 2016 to 1st quarter 2020*' (19 May 2020): https://www.statista.com/statistics/647374/worldwide-blockchain-wallet-users/ accessed 13 June 2020. A 'wallet' is effectively the equivalent of a digital bank account, and is used to hold and access digital assets either via an app or on a website.

[23] Helen Partz, '*19% of World Population Bought Crypto Before 2019: Kaspersky Report*' (21 June 2019): https://cointelegraph.com/news/19-of-world-population-bought-crypto-before-2019-kaspersky-report accessed 13 June 2020.

3.2 One of the consequences of the increase in awareness and popularity of digital assets was the explosion in the number of 'initial coin offerings' (known as "**ICOs**") especially between 2015 and 2018. The general premise of these ICOs was that individuals or entities looking to raise funds for start-up projects would seek funding from investors by promising to issue some form of digital assets (usually known as 'tokens' or 'coins') in exchange for the investment received. This type of public crowdfunding activity was totally different from the more widely understood concept of the initial public offering ("**IPO**") relating to shares in a public company. Unlike an IPO, ICOs hardly ever gave investors equity shares in the entities concerned, and there was little or no regulation of their promotion or conduct because legislatures and regulators struggled to react with sufficient speed to deal with this new phenomenon.

3.3 A relatively small number of ICOs were credible and were based upon solid business plans, but a large number of them had no credible idea or business plan; no underlying assets to support the funds generated; little or no regulation and few or no enforceable legal rights for investors. There are a number of examples of this type of ICO, but one of the stand-out candidates was an ICO called 'Useless Ethereum Token' ("**UET**") from summer 2017. This ICO was purposefully set up to illustrate the fallacy of the ICO craze. UET was openly stated to be a worthless digital asset. Its investor pitch said: "*UET is a standard ERC20 token, so you can hold it and transfer it. Other than that... nothing. Absolutely nothing.*" Despite this, it raised $40,000 from investors in under three days.[24]

Security token offerings

3.4 Fortunately, digital assets have evolved considerably in the last two years and a new concept of security token offerings ("**STOs**") has emerged. This, it is submitted, presents opportunities for the Isle of Man.

3.5 Security tokens are cryptographic tokens, just like tokens issued in ICOs, but crucially security tokens derive their value from real-world assets such as company shares or real property. They are sometimes known as 'asset-backed' or 'asset-linked' tokens. Taking security tokens issued by corporate entities as an example, instead of being given a physical share certificate and being entered into the company's register of members as would happen in a share purchase transaction, a purchaser of security tokens instead receives digital tokens and their ownership of those tokens is recorded on a digital ledger known as a blockchain.

3.6 STOs have gained acceptance and understanding from regulators across the world. When issued by entities in the United States of America, or when accessible to residents of the USA, they are generally subject to regulation by the Securities and Exchanges Commission in the USA because they meet the so-called '*Howey*' test. This test is similar (but not identical to) the definition of a collective investment scheme in Isle of Man law.[25]

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[24] Joon Ian Wong, '*Eager cryptocurrency investors have sunk thousands of dollars into joke tokens*' *(7 July 2017)*: https://qz.com/1023501/ethereum-ico-people-invested-thousands-of-dollars-in-useless-ethereum-token-uet/ accessed 13 June 2020.

[25] *SEC v Howey Co.* 328 US 293 (1946) (United States Supreme Court). This case established the test for whether an arrangement involves an investment contract (which then implies that the transaction is a security). The test is: (i) there is an investment of money; (ii) in a common enterprise; (iii) with an expectation of profit predominately from the efforts of others.

3.7 As is discussed further in paragraphs 3.8 – 3.14 below, offshore financial centres (in particular) have embraced the concept of security tokens and have enacted specific legislation designed to attract businesses and investors alike to take advantage of their tailored legal and regulatory regimes. The Isle of Man is falling behind in this area and risks ceding further competitive advantage to other jurisdictions such as Gibraltar, Bermuda, the Cayman Islands and Malta. Manx advocates are receiving credible enquiries from existing and new clients about establishing up STOs using Isle of Man vehicles[26] but it is submitted that the regulatory position is not yet sufficiently clear to enable advocates to give clear advice or to enable operators to establish themselves in the Isle of Man with sufficient confidence.

The current position in some competitor jurisdictions

3.8 Generally speaking, most jurisdictions have opted to regulate those persons operating in the digital asset sector rather than seeking to regulate digital assets or blockchain technology themselves. The Isle of Man already takes this approach, to a degree, and it is argued below that this should be extended further.

Gibraltar

3.9 Gibraltar was one of the first jurisdictions in the world to introduce legislation to regulate persons operating in the distributed ledger technology ("**DLT**") sector. The approach in Gibraltar is to regulate persons who use DLT for '*storing or transmitting value belonging to others*'.[27]

3.10 Between January 2018 and January 2019, Gibraltar had also issued licences to at least five cryptocurrency exchanges[28]. These exchanges are similar in nature to a more traditional stock exchange, with the obvious difference that cryptocurrency exchanges allow persons to trade digital cryptographic assets rather than equity securities. It is highly unlikely that the Isle of Man will enact legislation permitting the establishment and operation of cryptocurrency exchanges any time soon[29], but the Island can focus on other opportunities as is explained in paragraphs 3.15 to 3.22 below.

Bermuda

3.11 Pursuant to the *Digital Asset Business Act 2018,* any person carrying out certain activities relating to digital assets (including issuing, selling or redeeming virtual coins or tokens or any other form of digital assets; operating custodial wallet services or operating a digital asset exchange) must apply for a licence from the Bermuda Monetary Authority, Bermuda's financial services regulator. There is a specific definition of 'digital asset' in the legislation. The Head of Fintech (financial technology) in the Bermuda office of the law firm Conyers Dill and Pearman stated in a blog post last year:

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[26] The author has no quantitative data to support this statement but it is based upon personal discussions between the author and other Manx advocates in the 12 months prior to the date of this submission.

[27] Charltons Quantum, '*Regulation of Cryptocurrency and Initial Coin Offerings (ICOs) in Gibraltar*' (August 2018): https://charltonsquantum.com/regulation-cryptocurrency-initial-coin-offerings-ico-gibraltar/ accessed 13 June 2020.

[28] Lubomir Tassev, '*5 Crypto Exchanges Have Been Licensed in Gibraltar Since Regulation*' (10 January 2019): https://news.bitcoin.com/5-crypto-exchanges-have-been-licensed-in-gibraltar-since-regulation/ accessed 13 June 2020.

[29] This statement is based upon the author's discussions with staff in the authorisations team of the Isle of Man Financial Services Authority ("**IOMFSA**") during the first quarter of 2020. The IOMFSA does not have the capacity or the budget to regulate a digital securities exchange.

"Basically, the [Bermudan Act] is trying to achieve what the Island's Insurance Act did in 1978: the establishment of an entirely new sector of Bermuda's economy. One which is regulated by the Island's prime regulator, the Bermuda Monetary Authority. An industry which over time will become a new "economic pillar" for the Island. A fledgling digital asset industry which may also turn out to be an innovative example for other jurisdictions to follow."[30]

3.12 It is submitted that the Isle of Man should aim to follow the example set by Bermuda.

The Cayman Islands

3.13 The Cayman Islands does not presently have specific legislation covering digital assets, but a draft bill was published earlier this year.[31] Some of the aims of this bill (which is based on Financial Action Task Force guidelines followed by many other jurisdictions) are stated to be to:

- allow the Cayman Islands to compete with international competitors;
- bring about much-needed reforms in this area; and
- help cryptocurrency businesses with registration, operating procedures and compliance concerns.[32]

Malta

3.14 The Government of Malta enacted three laws at the beginning of July 2018 to specifically address digital innovation and cryptocurrencies. Broadly speaking, the Maltese approach follows that of the other jurisdictions listed above in regulating persons who utilise digital technology in their business, rather than regulating the technology itself.

The current position in the Isle of Man

3.15 The Designated Businesses (Registration and Oversight) Act 2015 ("**DBA**") states that all businesses which undertake '*convertible virtual currency activity*' must register with the Isle of Man Financial Services Authority ("**IOMFSA**") under the DBA, for the purpose of oversight of their anti-money laundering ("**AML**") and know-your-customer ("**KYC**") controls and procedures. '*Convertible virtual currency activity*' is very widely defined in the DBA and is likely to capture virtually every business which deals with virtual currencies in one form or another. The DBA is an important piece of legislation because it shows the Island's commitment to maintaining the highest standards of AML and KYC compliance in an area which presents inherent risks due to the anonymous (or in some cases pseudo-anonymous) nature of digital assets.

3.16 In February 2019, Digital Isle of Man (one of the four executive agencies of the Department for Enterprise) launched the Isle of Man Blockchain Office, an initiative aimed at encouraging innovation and development of businesses which use blockchain technology

[30] Chris Garrod, '*Bermuda's Digital Asset Revolution*' (17 April 2019): https://medium.com/@ChrisGGarrod/bermudas-digital-asset-revolution-8a655619dd56 accessed 13 June 2020.
[31] The Virtual Assets (Service Providers) Bill 2020. See Gurpreet Thind, '*Cayman Islands crypto regulations bill to promote fiscal transparency*' (2 May 2020): https://www.cryptopolitan.com/cayman-islands-crypto-regulations/ accessed 13 June 2020.
[32] Thind (ibid.).

in one form or another. The Blockchain Office is a public and private sector collaboration staffed with representatives from the Department for Enterprise and also from industry. In order to grow this area of the Manx economy and make the Island an attractive place for blockchain-based businesses, the Blockchain Office administers a regulatory 'sandbox' which is essentially a test-bed for blockchain companies to showcase their operations and to work with the Blockchain Office and the IOMFSA in order to establish whether the business requires regulatory approval. In common with the approach in Bermuda, Gibraltar and Malta, the Island operates 'blockchain-agnostic' regulation in that it only seeks to regulate certain uses of blockchain technology rather than regulating the technology itself.

3.17 The Blockchain Office has achieved success in its first fifteen months of operation. Out of a total of more than sixty applications, it has accepted over forty businesses for further review and evaluation[33].

A blueprint for the future

3.18 It is submitted that there is uncertainty in Manx law about public security token offerings and how they interact with the existing legislation governing collective investment schemes (the "**CIS legislation**"). This is because the Regulated Activities Order 2011 (as amended) (the "**RAO**") and the CIS legislation were enacted long before digital tokens came into existence. In order to advise on whether something is a security in Manx law, it is necessary to consider the definition of "*investment*" in the RAO, but security tokens (and indeed digital assets generally) are not easy to categorise in this respect.

3.19 The Isle of Man should adopt specific legislation, similar to the Bermudan model, which carves out digital assets from the scope of the CIS legislation and which creates a clear framework for persons wishing to issue; transfer or provide custody services for security tokens. This step would bring the Island up to speed with competitor jurisdictions like Bermuda and would provide clarity and certainty about what will constitute a security token in Manx law.

3.20 The Blockchain Office and the IOMFSA are aware that there is some uncertainty amongst industry professionals regarding the interaction between the CIS legislation and offers of security tokens to the public. These two bodies have been working on a joint guidance note (due to be published imminently) which will, it is hoped, address the areas of concern and the frequently asked questions that are arising from those interested in this subject.

3.21 The Blockchain Office website states its commitment to be a 'fast follower' in this evolving area of law and regulation[34] i.e. the Isle of Man's approach is to survey the legal and regulatory landscape in other jurisdictions and then adopt best practice from those jurisdictions in order to achieve the optimal legal and regulatory environment for the Island. This is a sensible approach and should be encouraged, but the Island now needs to move quickly to capitalise on its established expertise in the collective fund services industry and its international reputation of stringent AML and KYC standards, otherwise it will fall further behind other jurisdictions which have already enacted specific legislation in this area.

[33] Based upon the author's discussions with members of the Blockchain Office in April 2020.
[34] https://www.digitalisleofman.com/blockchain-isle-of-man/ accessed 14 June 2020.

3.22 It must be stressed that the Island should only be seeking quality business from credible operators. The Island cannot and should not risk losing its present status as a professional and well-regulated jurisdiction in which to do business, but it is argued that this can be achieved with an appropriate and clear regulatory regime which ensures that security token offerings are not only AML and KYC compliant, but are also properly understood and supervised (where necessary) by the IOMFSA.

4. The third possible reform – more permissive regulation of medicinal cannabis and funds derived therefrom

4.1 Medicinal cannabis is a hot topic at present, as quite a number of jurisdictions (for example Mexico, Canada and many states in the USA) have taken steps in recent years to permit some uses of cannabis for medical purposes. It is argued below that although this is an emotive topic with a range of differing views, there are two possible advantages which the Isle of Man could gain from introducing more permissive regulation in this area.

4.2 Cannabis is a controlled drug in the Isle of Man pursuant to the Misuse of Drugs Act 1976, so it is presently illegal to import; possess; supply or cultivate it. In November 2018, the UK amended the classification of cannabis under the Misuse of Drugs Regulations 2001, so that cannabis now has recognised medical uses in certain limited circumstances[35]. Recognising this, on 6 February 2019 the Isle of Man Government Department of Health and Social Care issued two public consultations entitled: "*Prescribing of Medical Cannabis*" and "*Changes to Allow Industrial Hemp Production*" to gauge public opinion as to whether the Isle of Man should follow the approach taken in the UK. These consultations closed on 20 March 2019. In relation to the "*Prescribing of Medical Cannabis*" consultation (with which this essay is concerned) of the 3,825 responses submitted, 95% of respondents said they would support the cultivation and manufacture of medicinal cannabis products in the Isle of Man subject to a suitable regulatory framework, and only 0.8% of respondents were not in favour of the introduction of medicinal cannabis at all[36].

4.3 In the event that the research and/or production of certain medicinal cannabis products is legalised on the Isle of Man, there is clearly a potential benefit to the Manx economy from the point of view of increased employment opportunities and the attendant benefits that this would bring (including, for example, increased income tax revenue and national insurance contributions). Based upon the feedback given in the public consultations, there is clear public appetite for a relaxation of the present legislative framework, in the right circumstances and subject to appropriate controls.

4.4 The Island could gain a further competitive edge in this area by amending section 141 of the Proceeds of Crime Act 2008 ("**POCA**"). In summary, section 141 of POCA states that a person commits a criminal offence if they acquire, use or possess criminal property (unless that person meets one of the exemptions in section 141). Property is "criminal property" if it constitutes a person's benefit from criminal conduct.

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[35] Sarah Ellson and Aymen Khoury, '*10 Things You Need to Know About Medicinal Cannabis in the UK*' (17 July 2019) (https://www.fieldfisher.com/en/insights/10-things-you-need-to-know-about-medicinal-cannabis-in-the-uk) accessed 23 June 2020.

[36] Isle of Man Government Department of Health and Social Care, '*Prescribing of Medicinal Cannabis*' https://consult.gov.im/health-and-social-care/medicinal-cannabis/ accessed 23 June 2020.

4.5 Section 141(3) of POCA states that a person does not commit the offence of acquiring, using or possessing criminal property if:

> *(a) that person knows, or believes on reasonable grounds, that the relevant criminal conduct occurred in a particular country or territory outside the Island; and*
>
> *(b) the relevant criminal conduct —*
>
> > *(i) was not, at the time it occurred, unlawful under the criminal law then applying in that country or territory; and*
> >
> > *(ii) is **not** [author's emphasis] of a description prescribed by an order made by the Department of Home Affairs.*

4.6 This provision must be read with paragraph 2(3)(2) of the *Proceeds of Crime (Money Laundering - Exceptions to Overseas Conduct Defence) Order 2013* (the "**2013 Order**") which states as follows:

> *"Subject to paragraph (3) such relevant criminal conduct is conduct, in the particular country or territory where it occurred, which would constitute an offence punishable by custody for a maximum term in excess of 12 months if it had occurred in the Island".*

4.7 The effect of section 141(3) of POCA when read with the 2013 Order is that a person will not commit a primary money laundering offence in the Isle of Man if they obtained proceeds from conduct which was unlawful in the Isle of Man, but lawful in the territory where the conduct occurred, but only if that conduct would be punishable in the Isle of Man by a custodial term of less than 12 months.

4.8 When s. 141(3) of POCA and the 2013 Order are considered in the context of medicinal cannabis, the legal position is that any person in the Isle of Man who receives property (for example cash) which is derived from the lawful research/sale/production of medicinal cannabis in another country, risks committing a primary money laundering offence in the Isle of Man because Manx law presently prescribes a maximum custodial sentence far in excess of 12 months for the production/supply/possession of controlled drugs (the maximum custodial sentence is in fact 14 years).

4.9 Taking a practical example:

a) a person incorporates an Isle of Man holding company which owns all of the shares in a Canadian subsidiary;

b) The Canadian subsidiary carries out research into medicinal cannabis and produces medically-approved products in a lawful manner in accordance with the laws applicable in Canada;

c) The Canadian subsidiary makes a profit and proposes to pay a cash dividend to its Isle of Man parent company; but

d) In receiving the dividend, the Isle of Man parent company would be in breach of POCA because although the production of cannabis-based products is legal in Canada, this activity presently carries a maximum custodial sentence in the Isle of Man of greater than 12 months.

4.10 It could be argued that:

a) the Manx authorities would never actually prosecute in the scenario given in paragraph 4.9, and/or

b) the Isle of Man company could apply to the Financial Intelligence Unit ("**FIU**") for consent to receive the dividend from the Canadian company,

but neither of these arguments satisfactorily addresses the legal risk which the current law presents. It is simply not commercially viable to assume that a prosecution would never be brought, or to rely on consent from the FIU each time funds are to be remitted to the Island (it is not possible to obtain 'blanket' consent in relation to the same subject matter).

4.11 Guernsey in particular has recognised the opportunities that medicinal cannabis presents. It is now legal to produce cannabis for certain medical uses in Guernsey[37]. On 10 June 2020, the Guernsey Financial Services Commission ("**GFSC**") issued a statement to the effect that the GFSC would consider applications to register Guernsey-incorporated collective investment schemes which intend to invest in certain defined areas relating to medicinal cannabis[38].

4.12 On the same day, the Policy & Resources Committee of the States of Guernsey (the "**Committee**") issued a statement which went even further. This statement provides (in summary) that Guernsey's anti-money laundering legislation will not apply to the proceeds of the lawful cultivation and production of cannabis in another country for recreational purposes. In an article published the following day, a partner in the law firm Ogier commented (this author's emphasis in bold):[39]

> "*The Committee has stated that Guernsey's anti-money laundering legislation will not apply to the proceeds of the lawful cultivation and production of cannabis for recreational purposes in any country where such cultivation and production is lawful. Guernsey's anti-money laundering legislation will still apply in respect of any such drug-related activities which are otherwise unlawful in those countries.*
>
> *We would note that the position stated by the Committee is not been [sic] conclusively determined by the Royal Court in Guernsey, however the statement is helpful in setting out the Committee's view on how Guernsey's anti-money laundering regime is intended to operate.* ***These are helpful clarifications for investors wishing to efficiently structure their investments into an increasing number of jurisdictions which now permit the cultivation of cannabis and the production of cannabinoid-based products***".

4.13 It would greatly assist natural and legal persons on the Isle of Man from a legal certainty point of view, and it would enhance the Island's competitive position, if the Manx authorities were to issue a statement similar to those issued by the authorities in Guernsey. Although at this stage it may be a step too far for the Isle of Man to countenance off-Island investment in recreational cannabis products, it is argued that the strength of public opinion in the Isle

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[37] Government of Guernsey, '*Medicinal Herbal Cannabis*' (10 June 2020): https://www.gov.gg/mhc accessed 23 June 2020.
[38] Guernsey Financial Services Commission, '*Cannabis Funds*' (10 June 2020): https://www.gfsc.gg/news/article/cannabis-funds accessed 23 June 2020.
[39] Craig Cordle, '*Investment by Guernsey vehicles into cannabis and other drug-related assets*' (11 June 2020): https://www.ogier.com/news/investment-by-guernsey-vehicles-into-cannabis-and-other-drug-related-assets accessed 23 June 2020.

of Man as shown by the 2019 consultations is such that the Isle of Man Government and the IOMFSA should consider positioning the Isle of Man as being 'open for business' in respect of making investments in medicinal cannabis in jurisdictions where such medicinal uses are lawful, and that any proceeds derived from such activities and remitted to the Isle of Man should fall outside the scope of POCA.

4.14 This subject clearly invokes a number of differing opinions and there are obvious public policy considerations surrounding cannabis and its uses. It is submitted that it would be inappropriate at this stage for the Island to consider relaxing its legislative regime in respect of the recreational use of cannabis on the Island (indeed this subject was not discussed in the public consultations). It is argued that the Isle of Man should maintain a 'watching brief' on this area of the law and should be prepared to move quickly to preserve competitive advantage whilst adhering to the highest international standards.

5. Conclusion

In summary, it is argued that the three possible reforms identified in this essay would enhance the Isle of Man's legal system and would go some way towards making the Island more competitive as an offshore financial centre for the reasons explained in each section above. Each of the reforms would of course require further consideration and consultation before being implemented, but it is submitted that the potential benefits that they offer would significantly exceed the time and cost investment which would be necessary to bring them into effect.

Adam Killip
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