

21ST CENTURY DIGITAL FUNDS

by Joel Taylor

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A few years ago, the raising of funds looked to have an exciting future. Crowdfunding and peer-to-peer financing were becoming ever more popular; Bitcoin was gaining legitimacy; Blockchain, the technology behind Bitcoin, was attracting serious interest; and generally financial technology (Fintech) was rapidly evolving. That is still true today but the legal and regulatory framework is taking longer to develop. Jersey as an innovative jurisdiction is working hard to meet the challenges.

CROWDFUNDING AND PEER-TO-PEER

Crowdfunding is a method of raising funds for a project or an idea from a large number of people usually via an online platform. Crowdfunding falls into four main types – Donation, Reward, Investment or Loan:

- Donation-based crowdfunding is where people give money to a person or organisation to support their activities.
- Reward-based (or pre-payment-based) crowdfunding is where people give money in return for a reward, service or product.
- Investment-based (or equity-based) crowdfunding permits investment in new or established businesses (typically in illiquid securities such as shares in a company).

- Loan-based (or debt-based) crowdfunding, also known as 'peer-to-peer lending', where people lend money in return for interest payments and a repayment of capital over time.

The advantages of crowdfunding can include speed (utilising existing online platforms), flexibility (in the way you present your pitch) and potentially reaching a wide audience (the general public). For those funding, they get the opportunity to participate (when they otherwise might not have access) and in the case of investment-based or loan-based crowdfunding, generally a chance to obtain higher returns than more traditional investments or financings.

Regulators have typically concentrated on investment-based and loan-based crowdfunding as being more problematic and higher risk and have looked to restrict the people who can play in this space such as requiring online platforms to have a certain level of financial resources or by limiting investment to sophisticated or high net worth investors. Donation and reward-based crowdfunding is mostly unregulated although they can raise a significant amount of money which brings reputational and other risks (one of the most successful rewards-based crowdfunded projects, the development of an internet space game called Star Citizen, has so far raised over US\$112 million and counting).

FINTECH

The online platforms used for crowdfunding are just one example of technology being applied to financial services. The Fintech industry initially arose to increase efficiency in financial services such as by providing better organisation, analysis and presentation of financial information. Fintech is experiencing rapid growth and evolution with one area being Bitcoin but more importantly, by applying its underlying technology, the blockchain, in novel ways.

BITCOIN

Bitcoin is a type of virtual currency (also called a digital or crypto-currency). It is an electronic store of value, which operates without a central repository or administrator. Transactions are verified and recorded in a public distributed ledger called the blockchain (see below).

Jersey has been at the forefront of recognising the legitimacy of Bitcoin. In July 2014, the Jersey Financial Services Commission authorised the first Bitcoin collective investment fund (that is, a fund that invests in Bitcoin as an asset class). Jersey is also proceeding with plans to pass legislation later this year which will establish rules for the use of crypto-currencies such as Bitcoin.

BLOCKCHAIN

Blockchain is a way of storing data based on a global decentralised ledger. Digital records are grouped together into 'blocks' and by using complex mathematical algorithms are encrypted (by agreement between a large number of computers in a process known as 'hashing') in chronological order into a continuously-growing 'chain' of blocks with each block linked to the previous block. Details of the actual transaction aren't stored, just the fact that the transaction happened and the hash of the transaction (which cannot be converted back into the original data as it's a one-way process).

While blockchain is the technology which underpins Bitcoin, it can be applied to the storage of any data and not just validating Bitcoin transactions. Some potential uses being actively explored are in land and company registries or for tracking property/assets in emerging markets.

Blockchain technology is being developed and applied to make existing processes more efficient, secure, transparent and cheaper. Efficient because there are minimal delays in carrying out execution of transactions

as there are no intermediaries; secure because of encryption and the reduced possibility of fraud and error with a distributed/shared ledger; transparent as much of the data in the blockchain is public (although the data is public, the identity of whom the data relates to is not); and cheaper because of lower costs and improved accessibility.

Blockchain is not only being used to enhance existing processes but because of its potential application has become an attractive investment option itself. Appleby has recently helped establish a fund in Jersey that invests in blockchain technology as an asset class.

21ST CENTURY DIGITAL JERSEY

Crowdfunding fills a (currently) small but significant space in the fundraising ecosystem. Crypto-currencies such as Bitcoin are changing the way we think about and use money. Blockchain would seem to hold the most potential for evolution and could be a disruptive force in the financial services industry. The legal and regulatory framework around Fintech has taken time to develop and is continuing to evolve alongside the technology. The States of Jersey has set up a working group with an industry body, Digital Jersey, to monitor and react to developments in Fintech and the effects of regulation. The aim is to ensure that there are adequate protections in place without stifling innovation. This will allow Jersey to take full advantage of the opportunities available and ensure that it takes its place as a leading 21st century digital funds centre.

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