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Cryptocurrencies and asset protection trusts in the Cayman Islands

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Introduction

Bitcoin and other cryptocurrencies have led to enormous wealth being generated, rapidly taking individuals from modest means to the realms of the ultra-wealthy. This almost overnight wealth creation is likely to have a significant impact on the traditional private wealth industry as cryptocurrency holders take steps to protect their assets and will lead to new and innovative wealth structures being created as these seemingly disparate industries converge.

As discussed below, recent developments in this area lead to the conclusion that Cayman Islands (**Cayman**) trusts and private wealth (**TPW**) structures are likely to be ideal vehicles for holding cryptocurrencies (an asset class which has quickly gone from fringe to mainstream). The specific structures on offer in this jurisdiction helpfully address many of the practical considerations which are relevant when establishing a TPW structure to hold cryptocurrencies and are supported by highly skilled service providers on island.

Recent developments

In recent months there have been a number of key developments which create favourable conditions for the merger of TPW and cryptocurrencies in Cayman and should in particular give prospective trustees and service providers comfort in agreeing to hold and administer cryptocurrencies.

- The introduction of the Cayman Islands Virtual Asset (Service Provider) Law 2020 (**VASP Law**)[1], which *inter alia* regulates virtual assets service providers, further signalling Cayman's desire to encourage technological development and creating much needed certainty for those operating in the cryptocurrency space. This new legislation, and the clear guidelines it brings with it, will no doubt increase Cayman's attractiveness as a domicile for virtual assets business.
- The recent decision of the England and Wales High Court[2], which provides that crypto-assets are to be treated as 'property' under English law and the subsequent New Zealand High Court decision in *Ruscoe v Cryptopia Limited (in Liquidation)*[3] which found that cryptocurrencies are a type of intangible property capable of being held on express trust. These decisions are likely to have wide-reaching implications in terms of succession and for the creation of trusts that require certainty of subject matter (i.e. property) to be valid.

1 Gazetted on 25 May 2020 but not yet in force.
2 AA v Persons Unknown [2019] EWHC 3556, [2020] 4 WLR 35 at [57]–[59]
3 [2020] NZHC 728; (2020) 5 NZTR 30-001.

- Bitcoin is now accepted as an asset class in its own right as evidenced by top hedge fund manager Paul Tudor Jones confirming that he is now holding Bitcoin[4] in one of his funds, while other global macro investors have also highlighted Bitcoin as a preferred asset class. In addition, institutional investment vehicles such as Grayscale Investments LLC (registered with the US Securities and Exchange Commission), which enables a broad range of investors to gain cryptocurrency exposure, has over US$3.5bn under management in its flagship Bitcoin Trust (having received over US$ 1.4bn of investment in the first two quarters of 2020 alone).
- NASDAQ listed billion dollar software company, Microstrategy Inc, a company not involved in cryptocurrency or blockchain, taking the decision to hold its cash reserves of US$250m in Bitcoin on the basis that "*this investment reflects our belief that Bitcoin, as the world's most widely-adopted cryptocurrency, is a dependable store of value and an attractive investment asset with more long-term appreciation potential than holding cash*" and that "*MicroStrategy has recognized Bitcoin as a legitimate investment asset that can be superior to cash and accordingly has made Bitcoin the principal holding in its treasury reserve strategy*". [5]
- The announcement on 22 July 2020 by the United States Office of the Comptroller of Currency that US nationally chartered banks can provide custody services for cryptocurrencies, a further sign that cryptocurrencies are being accepted by regulatory authorities as a legitimate asset class. This should give prospective trustees and service providers' confidence when asked to hold and administer cryptocurrencies.
- The advent of fiat-backed digital currencies commonly referred to as "stablecoins", allowing fiat currencies to be circulated via blockchain networks and enabling users to quickly and seamlessly move between cryptocurrencies and fiat (providing a mechanism for managing volatility risk).
- The announcement by Visa[6] that users can now link their cryptocurrency wallets to their Visa accounts enabling them to spend cryptocurrencies using a Visa debit card.

Benefits of a Cayman Islands trust or wealth structure

Before looking at the specific Cayman structures which may be suited to holding cryptocurrencies, it is worth setting out some of the main benefits of a Cayman trust, most of which arise from the distinction between the legal owner of the trust property (the trustee) and those that can use or benefit from the trust property (the beneficiaries).

- **Asset protection** – when assets are transferred from the original owner (called a settlor) to a trustee (to be held for the benefit of the beneficiaries or purposes of the trust) those assets are no longer part of the settlor's personal estate. As a consequence, personal creditors of the settlor (or the beneficiaries) typically cannot access the trust assets.[7] A trust can also prevent assets becoming relationship property and offers protection in the event of a family breakdown.

  In addition, using a trust should prevent a situation where a person dies holding cryptocurrencies that their family do not know about and/or cannot access because they cannot locate or access the relevant private keys. This risk was famously highlighted by the sudden death of the CEO of a major Canadian cryptocurrency exchange, QuadrigaCX, who died holding the only private key to $137m worth of cryptocurrency, effectively freezing the company's assets.[8]
- **Succession / estate planning** – placing assets into a trust provides a greater degree of control over what ultimately happens to those assets. For example, a trust can be established to benefit certain persons or charities, something that may not happen on a person's death given the applicable statutory regimes in their home jurisdiction.
- **Avoidance of probate formalities** – assets owned by an individual usually pass on their death in accordance with a will. If a deceased person has assets in a variety of countries, it may be necessary to obtain a grant of probate in each country where the assets are located, something which can be expensive and time-consuming. This may be particularly difficult for cryptocurrencies which require access to the private keys before they can be transacted. Assets settled on trust on the other hand, can be held for the benefit of succeeding generations and the death of the individual should have no detrimental consequences for the continued operation of the trust.

4 In the form of Bitcoin futures (https://www.cnbc.com/2020/05/07/paul-tudor-jones-reportedly-buys-bitcoin-as-an-inflation-hedge-compares-crypto-to-70s-gold-trade.html).

5 According to Microstrategy's CEO, Michael Saylor (https://ir.microstrategy.com/news-releases/news-release-details/microstrategy-adopts-bitcoin-primary-treasury-reserve-asset).

6 https://usa.visa.com/visa-everywhere/blog/bdp/2020/07/21/advancing-our-approach-1595302085970.html

7 Provided the trust is not created to defraud or put assets out of reach of creditors.

8 https://www.wired.com/story/crypto-exchange-ceo-dies-holding-only-key/#:~:text=04%3A57%20PM-,A%20Crypto%20Exchange%20CEO%20Dies%E2%80%94With%20the%20Only%20Key%20to,effectively%20freezing%20the%20company%27s%20assets.

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- **Forced heirship** – a trust may be a good way of providing more flexibility than allowed under rigid forced heirship regimes in a person's home jurisdiction; if a person is domiciled in a jurisdiction with forced heirship, their assets will pass by law to their statutory heirs. Using a trust created during their lifetime can therefore allow a person to determine who ultimately receives their cryptocurrencies or the profits that arise.
- **Confidentiality** – trusts are generally created by private document which does not need to be registered or filed with any public body in Cayman and information relating to the trust is not accessible by the general public[9]. This can help to shield a person and their family from unwanted media attention that large cryptocurrency holdings may bring.
- **Tax advantages** - a Cayman trust offers fiscal neutrality by virtue of the fact that Cayman has no gift, estate, income or capital gains taxes. As such, any gains made by cryptocurrencies held in a Cayman trust may not attract capital gains or other taxes (something which of course should be checked with onshore advisors before any TPW structure is established).
- **Robust system** – Cayman offers a sophisticated professional services industry supported by modern trusts legislation and an effective judicial system, an important combination when considering a trust over novel assets such as cryptocurrencies.
- **Protection from foreign courts** – Cayman's "firewall" legislation means that the Cayman court will generally not recognise any foreign order made in respect of a Cayman trust which conflicts with Cayman law. For example, an order by a civil law court that the Cayman trust is not valid would not normally be recognised by the Cayman court.

Suitable Cayman structures

On top of the generic benefits of a Cayman trust, Cayman offers a range of structures which appear well suited to holding cryptocurrencies as highlighted briefly below.

- **STAR trusts** – a creature of the Cayman Special Trusts (Alternative Regime) Law 1997 - can be established for beneficiaries or purposes (charitable and non-charitable) or both and are often used to hold speculative assets because it can have holding specific assets or classes of assets as a stated purpose. A STAR trust is not subject to the 150 year perpetuity period which applies to ordinary Cayman trusts and can therefore be used to create a perpetual vehicle to hold wealth over generations.

  STAR trusts are likely to be favoured by trustees on the basis it is hard to criticise a trustee for large losses resulting from cryptocurrencies when the stated purpose of the trust requires the trustee to hold cryptocurrencies.
- **Reserved powers trusts** – Cayman expressly permits trusts being created which contain powers over the trust and its administration reserved to someone other than the trustee. Often reserved powers are used to allow the settlor of the trust to retain control over how the trust assets are invested. For example, if a trust is to be used to hold cryptocurrencies, the settlor of the assets could retain the power to direct the trustee as to whether and when it should dispose of the cryptocurrencies held on trust.
- **Foundation Companies** – foundation companies draw together features of traditional limited liability companies (such as separate legal personality) and civil law foundations and are therefore popular with people civil law jurisdictions where trusts are not common. Foundation companies are ideal vehicles for holding riskier assets as any duties by the directors are owed to the company and not to beneficiaries.

In addition to the structures mentioned above, because of the flexible nature of trusts, it is also possible (and indeed recommended) to incorporate bespoke provisions into a trust deed or foundation company constitution to adequately protect the assets and manage risk to the trustee.

Practical considerations

Whilst Cayman private wealth structures appear to have key attributes which make them suitable for holding cryptocurrencies, there are some practical considerations worth highlighting.

- **Source of wealth / source of funds** – Cayman trustees and corporate service providers are subject to strict Anti-Money Laundering requirements meaning that for any wealth structure, evidence of the person or family's source of wealth / source of funds will need to be provided. For cryptocurrencies, given their pseudo-anonymity, providing satisfactory source of wealth evidence may present challenges for persons wanting to create a structure to hold cryptocurrencies or their proceeds. For those with complete records showing initial purchases of cryptocurrencies and evidence of any gains, this may not be problem.
- **Custody** – given the intangible nature of cryptocurrencies, the most challenging aspect for trustees will be ensuring safe custody of their private keys in a manner acceptable to settlors. This is however unlikely to be insurmountable and there are providers in Cayman such as Strategic Wealth Preservation (SWP) which will store private keys in their vault for an annual fee, something trustees may prefer over providing custody in-house. US banks now may also be a viable option.

  As an alternative which avoids the issues associated with custody, a trust could own shares in a cryptocurrency vehicle

9 Noting that Cayman is party to various international agreements, now commonplace in offshore jurisdictions, for the exchange of information with authorities in other contracting states.

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such as those provided by Grayscale.

- **Volatility** – cryptocurrencies have tended to be volatile which could present risks for trustees if there is a market crash and the trust suffers significant losses as a result. It is therefore important to have in place clear guidelines around the management of the cryptocurrencies to mitigate losses to the trust fund as well as protections in place for the trustees for market movements. Bespoke drafting is likely to be required in this regard.
- **Jurisdiction** – again, because of the intangible nature of cryptocurrencies, careful and tailored jurisdiction provisions will be required to take account of the location and custody of the cryptocurrencies.

There are likely to be other aspects to consider when establishing a TPW structure depending on the settlor's personal circumstances, their location and the nature and storage of their cryptocurrencies.

Conclusion

As the world of cryptocurrencies converges with the TPW industry, more and more people will turn to properly administered private wealth structures for asset protection and to provide for future generations. As discussed above, the Cayman Islands, with its various options and flexibility, appears to be an obvious choice.

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