



Cayman Islands
blockchain and
cryptocurrency
regulation 2020,
second edition

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Government attitude and definition

The Cayman Islands is a leading global financial centre and has, over the course of several decades, developed a reputation as one of the world's most innovative and business-friendly places to operate. The jurisdiction offers a stable society and political system, judicial and legislative links to the United Kingdom, tax neutrality, many sophisticated service providers, and a proportionate regulatory regime that focuses closely on the financial services industry, and in particular those catering to sophisticated and institutional investors based elsewhere.

It is this reputation and these attributes that have helped the jurisdiction become an obvious choice for many of those proposing to establish fintech-related structures, whether it be in the form of a fund vehicle investing into Digital Assets,¹ an exchange for the same, an initial coin offering ("ICO"), or otherwise.

Each of the Cayman Islands Government, the Cayman Islands Monetary Authority ("CIMA"), and industry bodies such as Cayman Finance, acknowledge the importance of continuing to attract fintech business to the jurisdiction and ensuring the further growth of the sector. They are also aware, however, of the need to balance this approach with maintaining the Cayman Islands' commitment to the highest standards of financial probity and transparency and the specific considerations that can accompany Digital Assets.

Consequently, there has been no precipitous introduction of new regulation of the Digital Asset space, but rather a more judicious review of the sector and existing regulatory framework. Currently, the Cayman Islands Government is in the process of considering the proposals of an industry working group convened by CIMA regarding the adoption of any additional regulatory measures or governance standards for the marketing or trading of Digital Assets within and from the Cayman Islands. It is anticipated that the conclusion of this review will be made public shortly, but our expectation is that the results of the process are unlikely to lead to a wholesale or dramatic change of the current regulatory burdens, and will instead maintain the existing pro-industry approach while providing welcome clarification on certain areas of potential ambiguity.

In advance of the publication of such review and any steps to implement the same, however, this chapter sets out the current legal position in the Cayman Islands.

Cryptocurrency regulation

Save for certain aspects of the Cayman Islands anti-money laundering regime (as further detailed below), the Cayman Islands has not enacted any law or imposed any regulation that specifically targets Digital Assets.

As such, whether any activity involving a Digital Asset is subject to regulation will largely be determined in accordance with: (a) the nature of the activity being conducted; and (b) how the relevant Digital Asset would best be classified within the existing legislative framework.

Although a detailed analysis of each is outside the scope of this chapter, a summary of the statutory regimes that are most likely to be of relevance are as follows:

The Mutual Funds Law

Pursuant to the Mutual Funds Law of the Cayman Islands, an entity formed or registered in the Cayman Islands that issues equity interests and pools the proceeds thereof, with the aim of spreading investment risks and enabling investors to receive profits or gains from the acquisition, holding, management or disposal of investments, may come within the ambit of that statute and be required to obtain a registration or licence from CIMA.² The particular nature or classification of the Digital Assets will not generally be of relevance, provided they are being held as an investment.

As such, any pooling vehicle that is investing into the Digital Asset space or accepting Digital Assets by way of subscription and then investing into more traditional asset classes, would be advised to seek Cayman Islands legal advice on the point.

The Securities Investment Business Law

Pursuant to the Securities Investment Business Law of the Cayman Islands, an entity formed or registered in or that is operating from the Cayman Islands which engages in dealing, arranging, managing or advising on the acquisition or disposal of Digital Assets, may come within the ambit of the Securities Investment Business Law and be required to obtain a registration or licence from CIMA. This will, however, only apply to the extent that such Digital Assets constitute "securities" for the purposes thereof. The statute contains a detailed list of assets that are considered securities thereunder. Although such list does not currently make specific reference to any Digital Asset, in our view, certain types of Digital Asset are likely to constitute securities. Consequently, consideration will need to be given on a case-by-case basis as to whether the Digital Asset in question falls within one of the existing categories; for example, instruments creating or acknowledging indebtedness, options or futures. Equally, however, it seems clear that certain Digital Assets are likely to fall outside the definition, and thus outside the scope of the law (for instance, pure utility tokens and some cryptocurrencies).

The Money Services Law

Please see below for further details.

Anti-money laundering regulations

Please see below for further details.

Sales regulation

There are no securities or commodities laws in force in the Cayman Islands that apply specifically to Digital Assets (although please see the requirements of the Securities Investment Business Law as detailed above), whether in relation to their marketing and issuance by a Cayman Islands entity (e.g. pursuant to an ICO), or their sale by an existing holder.

In relation to the offering of securities or interests more broadly, where issuances or sales are targeted at investors based outside of the Cayman Islands, Cayman Islands law does not generally impose any prohibition or regulatory burden; it will instead look to the local authorities where such investors are based, to restrict or regulate the same as they see fit. With that said, this is one area in which the Cayman Islands Government's review may lead to further regulation; specifically, in circumstances where structures are established in order to offer Digital Assets to retail investors based elsewhere. Whether or not this is seen as a suitable step will, however, likely depend in part on the speed with which the major on- shore jurisdictions clarify their approach to Digital Assets under their own securities law regimes.

In relation to the offering, sale, or issuance of interests *within* the Cayman Islands, however, certain regulatory provisions should be borne in mind. For example, the Companies Law prohibits any exempted company formed in the Cayman Islands and not listed on the Cayman Islands Stock Exchange from offering its securities to the Cayman Islands public. The Limited Liability Companies Law includes a similar prohibition in relation to LLCs. Even persons based, formed or registered outside the Cayman Islands should be careful not to undertake any activities in relation to a sale or issuance of Digital Assets that would constitute "carrying on a business" in the Cayman Islands. To do so may entail various registration and licensing requirements and financial and criminal penalties for those who do not comply. There is no explicit definition of what will amount to "carrying on a business" for these purposes, and consequently, persons who propose to undertake concerted marketing to the Cayman Islands public, particularly if it involves engaging in any physical activity in the Cayman Islands, are encouraged to seek specific legal advice on the point.

In practice, however, these restrictions do not generally pose much of a practical concern for issuers given that:

- the "public" in this instance is taken to exclude other exempted companies, exempted limited partnerships, and LLCs (which together comprise the majority of Cayman Islands entities); and
- issuers' target investors tend not to include other persons physically based in the Cayman Islands themselves.

For completeness, and as detailed further above, Cayman Islands persons, or those operating from within the Cayman Islands, arranging for the sale or issuance of Digital Assets by another, may come within the ambit of the Securities Investment Business Law regardless of where the activity takes place, or the ultimate investors are based.

Taxation

There are no income, inheritance, gift, capital gains, corporate, withholding or other such taxes imposed by the Cayman Islands government, including with respect to the issuance, holding, or transfer of Digital Assets.

Stamp duty may apply to original documents that are executed in the Cayman Islands (or are brought into the Cayman Islands following execution). However, the sums levied are generally of a nominal amount.

Entities formed or registered in the Cayman Islands may also apply for and, upon the payment of a fee of approximately US\$1,830, receive a tax exemption certificate confirming that no law enacted in the Cayman Islands after the date thereof imposing any tax to be levied on profits, income, gains or appreciations shall apply to such entity or its operations. Such certificates will generally apply for a period of between 20 and 50 years (depending on the type of entity).

Money transmission laws and anti-money laundering requirements

Money transmission laws

Pursuant to the Money Services Law, any person carrying on a "money services business" in or from the Cayman Islands must first obtain a licence from CIMA. Any breach of this requirement will constitute a criminal offence.

For the purposes of the foregoing, a "money services business" means the business of providing (as a principal business), among other things, money transmission or currency exchange services.

Although there is no clear authority on the extent to which the foregoing would be seen to include such transactions in cryptocurrency or other Digital Assets, a cautious and substantive reading of the statute may, in some cases, warrant it. In particular, if the Digital Assets in question are primarily used to facilitate the transfer of fiat currency from one party to another, or the conversion between fiat currencies, the legislation may well apply. Consequently, persons wishing to establish such businesses are encouraged to consider closely the application of the Money Services Law and consult appropriate advisors.

Although a consideration of the requirements of the licensing application and approval process under the Money Services Law is beyond the scope of this chapter, it will generally require:

- the maintenance of specified capital levels;
- the appointment of approved auditors;
- the provision of audited financials to CIMA;
- the maintenance of proper records; and
- the payment of an annual fee.

Anti-money laundering requirements

The very nature and, in some cases, the intended features of Digital Assets can present heightened compliance risks and, moreover, practical hurdles to addressing the same. Such features may include the lack of a trusted central counterparty, increased anonymity, and ease of cross-border transfer without any gating or restriction.

Consequently, the Cayman Islands authorities have maintained a keen focus on balancing the jurisdiction's long track record of innovation and the promotion of a business-friendly environment with its commitment to the prevention of crime and maintaining robust standards of transparency. To date, this has been done, not by establishing an entirely separate regime for Digital Assets, but by applying the purposive approach enshrined within the existing framework which focuses on the specific activity and the nature of the assets in question so as to properly quantify the risk that the same may be used to facilitate illegal activity. With that said, we anticipate that the Cayman Islands authorities will continue to provide clarifying guidance and updates to address any ambiguities or uncertainties that arise in relation to the current regime.

Pursuant to the provisions of the Proceeds of Crime Law, the Anti-Money Laundering Regulations, and the guidance notes thereon (together the "AML Laws"), any persons formed, registered or based in the Cayman Islands conducting "relevant financial business" are subject to various obligations aimed at preventing, identifying, and reporting money laundering and terrorist financing.

"Relevant financial business" is defined in the Proceeds of Crime Law, and encompasses a broad variety of activity, including the following which may be of particular relevance in the context of Digital Assets:

- money or value-transfer services;
- issuing and managing means of payment (specifically including electronic money);
- trading in transferable securities;
- money broking;
- securities investment business; and
- investing or administering funds or money on behalf of others.

As such, the relevant requirements may depend on the type of Digital Asset in question; for instance, whether it can best be classed as a currency or money substitute, a security, a utility token or something else. We would thus generally expect businesses that engage in the operation of cryptocurrency exchanges, cryptocurrency issuances, brokering transactions in cryptocurrency, the trading and management of Digital Assets that are properly classed as securities, and the investment of funds (whether in the form of fiat currency or cryptocurrency) on behalf of others into Digital Assets, to come within the scope of the AML Laws. Notably, Digital Assets that are purely in the nature of utility tokens may fall outside of the ambit of the regime. However, specific legal advice on such distinctions is vital to ensure proper compliance and readers are encouraged to generally adopt a conservative approach.

Although a detailed consideration of the specific requirements of the AML Laws falls outside of the scope of this chapter, any person subject to the regime will generally need, among other things, to do the following:

- appoint a named individual as an anti-money laundering compliance officer to oversee its adherence to the AML Laws and to liaise with the supervisory authorities;
- appoint named individuals as the money laundering reporting officer and a deputy for the same to act as a reporting line within the business; and
- implement procedures to ensure that counterparties are properly identified, risk-based monitoring is carried out (with specific regard to the nature of the counterparties, the geographic region of operation, and any risks specifically associated with new technologies such as Digital Assets), proper records are kept, and employees are properly trained.

As above, particular practical concerns will often arise in relation to Digital Assets, specifically with regard to the identification of counterparties and the monitoring of source and use of funds. Most, in our experience, will be best advised to consult specialist third-party providers to assist with this process.

Promotion and testing

There are currently no 'sandbox' or other similar programmes in place in the Cayman Islands. However, the Cayman Islands Government has been vocal in promoting the Special Economic Zone ("SEZ") to those wishing to develop fintech-related products from the jurisdiction.

The SEZ offers businesses focused on the fintech industry the opportunity to establish physical operations within the Cayman Islands in a more streamlined manner. It provides several benefits, including a simpler, more rapid, and cost-effective work permit process, concessions with respect to local trade licences and ownership requirements, the ability to be operational within four to six weeks, and allocated office space.

When coupled with the other benefits of the jurisdiction and its recently updated intellectual property laws, the SEZ has proven highly popular with the fintech industry. To date, over 50 blockchain-focused companies have been established within it and this is expected to continue to grow. The SEZ also hosts a number of industry-focused events and conferences.

Ownership and licensing requirements

The Cayman Islands does not impose any restrictions or licensing requirements that are specifically targeted at the holding, management or trading of Digital Assets, whether by those doing so for their own account, or those doing so as a manager, trustee or advisor for the account of others.

As such, whether or not any such licensing or regulatory requirement is applicable to a particular activity will fall to be determined in accordance with the existing regulatory regimes, such as the Mutual Funds Law or the Securities Investment Business Law (each as further detailed above).

As also outlined further above, investment funds and managers that operate in the Digital Assets space are likely to need to comply with the requirements set out in the AML Laws.

Mining

The mining of Digital Assets is not regulated or prohibited in the Cayman Islands. We would note, however, that the import duties applicable to computing equipment and the high cost of electricity production in the Cayman Islands are likely to present practical deterrents to the establishment of any material mining operations within the jurisdiction. It is possible that the increased availability of renewable energy options, and the falling price of the same, may mitigate this somewhat in the future.

Border restrictions and declarations

The Cayman Islands does not impose any general border restrictions on the ownership or importation of Digital Assets.

As part of the Cayman Islands' commitment to combating money laundering and terrorist financing, the Customs (Money Declarations and Disclosures) Regulations mandate that individuals transporting money amounting to CI\$15,000 (approximately US\$18,292) or more into the Cayman Islands must make a declaration in writing to customs officers at the time of entry. However, the Customs Law defines "money" as being confined to cash (i.e. bank notes or coins that are legal tender in any country) and bearer-negotiable instruments (i.e. travellers cheques, cheques, promissory notes, money orders). As such, we would not expect such a requirement to apply to Digital Assets. Further, given the nature of Digital Assets, particularly those based or recorded on a distributed ledger, there is also the conceptual question of what would amount to the importation or transportation of the same.

Reporting requirements

There are no reporting requirements in the Cayman Islands specifically targeted at payments of, or transfers in, Digital Assets.

As above, to the extent that such a payment or transfer is made in the context of the conduct of "relevant financial business" for the purposes of the AML Laws, there may of course be an obligation to make certain filings or reports in the event that there is a suspicion of money laundering or other criminal activity.

Estate planning and testamentary succession

There is no particular regime under Cayman Islands law which deals specifically with the treatment of cryptocurrencies or other Digital Assets upon the death of an individual holding them. This means that, in principle, and assuming Cayman law governs succession to the deceased's estate, Digital Assets will be treated in the same way as any other asset and may be bequeathed to beneficiaries in a will, or, if a person dies intestate, will fall to be dealt with under the intestacy rules in the Cayman Islands Succession Law.

Although, as is the case in many jurisdictions beyond the Cayman Islands, there is likely to be some uncertainty as to where the *situs* of a Digital Asset is located (or indeed whether or not a *situs* can be determined at all), to the extent that the asset can be analysed under traditional conflict-of-laws rules as sited in the Cayman Islands, then a grant of representation would be required from the Cayman Islands court to preclude the risk of intermeddling claims in dealing with the asset in the Cayman Islands.

The main potential difficulty that may arise is practical; namely that anyone inheriting a Digital Asset will, on the face of it, often only be able to access that Digital Asset if the personal representative of the deceased or the beneficiary (as the case may be) has or can obtain the information needed in order to gain access and control over that Digital Asset (e.g. a private key to the wallet in which it is stored). Most exchanges have policies in place to transfer Digital Assets to next of kin but these policies, and the transfer requirements, will vary between the exchanges.



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Endnotes

1. For the purposes of this chapter, “Digital Assets” shall be used to include all forms of blockchain-based units, whether in the form of securities-like tokens, utility tokens, cryptocurrencies or otherwise.
2. Notably, if the entity itself is “closed-ended” in nature, it will generally fall outside the scope of the law.

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