

Virtual asset service providers in the Cayman Islands: an overview

The Cayman Virtual Asset (Service Providers) Act, 2020 (as amended) (the **VASP Act**) sets out a full regulatory registration and (from July 2021) licensing regime for virtual asset service providers (**VASPs**).

The VASP Act implements [Recommendation 15](#) (New technologies) of the Financial Action Task Force (FATF) on international standards on combating money laundering and the financing of terrorism and proliferation, together with the FATF's "[Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers](#)" (the **FATF Guidance**).

The Cayman Islands Government has introduced the VASP Act, together with amendments to a range of other Cayman Islands laws and regulations (such as the Securities Investment Business Act (2021 Revision), the Proceeds of Crime Act (2020 Revision) and the Anti-Money Laundering Regulations (2020 Revision) (as amended)), to ensure consistent recognition and treatment of VASPs and business activities involving virtual assets, particularly in relation to anti-money laundering compliance obligations.

Although it does not have any legal force in the Cayman Islands, the FATF Guidance is a primary source of information when interpreting the VASP Act. We expect that this will be confirmed when CIMA issues guidance on the VASP Act.

Under the VASP Act:

- A person shall not carry on, or purport to carry on, a virtual asset service in or from within the Islands unless that person:
 - Is registered with the Cayman Islands Monetary Authority (CIMA)
 - In the case of the provision of virtual asset custodial services or the operation of a virtual asset trading platform, holds a virtual asset service licence
 - Is licensed under an existing regulatory law in the Cayman Islands (such as the securities investment business or banking and trust company laws) and has been granted a waiver from the CIMA (in respect of its virtual asset operations); or
 - Holds a sandbox licence (a more flexible form of regulatory license); and
- A natural person shall not carry on, or purport to carry on, in or from within the Cayman Islands, a virtual asset service as a business or in the course of business.

Definition of a virtual asset

The VASP Act defines a virtual asset as: "a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes but does not include a digital representation of fiat currencies".

This definition is intentionally broad and focuses on transferability and exchangeability. According to the FATF, the definitions of virtual asset and VASP are intended: "to capture specific financial activities and functions (ie, transfer, exchange, safekeeping and administration, issuance, etc) and assets that are fungible—whether virtual-to-virtual or virtual-to-fiat".

Any blockchain-based token technically capable of transfer or exchange is a virtual asset under the VASP Act, regardless of programmed properties or intended use. No distinction is made between what are commonly known as utility tokens, security tokens and stablecoins.

The term "digital representations of fiat currencies", subject to any further guidance from CIMA, is likely only intended cover central bank digital currencies. For example, under the VASP Act, in our view, the Tether token is a virtual asset because it is backed by redeemable US dollar reserves held by the Tether company, rather than being a digital representation of the US dollar itself.

Virtual service tokens are not virtual assets

The VASP Act excludes "virtual service tokens", which are "a digital representation of value which is not transferrable or exchangeable with a third party at any time and includes digital tokens whose sole function is to provide access to an application or service or to provide a service or function directly to its owner".

The second part of the definition may seem to describe conventional utility tokens, but they are only virtual service tokens if they are also "not transferrable or exchange with a third party at any time".

The FATF offers more guidance on what is intended: this definition captures digital assets which are "closed-loop items that are non-transferable, non-exchangeable, and non-fungible. Such items might include airline miles, credit card awards, or similar loyalty program rewards or points, which an individual cannot sell onward in a secondary market".

Definition of a virtual asset service provider and virtual asset service

The VASP Act defines a VASP as:

- a Cayman entity;
- which provides a virtual asset service;
- as a business or within the course of a business in or from within the Cayman Islands; and
- and is registered or licensed in accordance with the VASP Act or is an existing licensee that is granted a waiver.

A virtual asset service is any of the following businesses provided for or on behalf of another party:

- The sale of newly created virtual assets to the public
- Virtual asset exchange (whether to or from fiat or other virtual assets)
- Transfers of virtual assets
- Custody services
- Participation in, and provision of, financial services related to a virtual asset issuance or the sale of a virtual asset

The VASP Act licenses and regulates those engaged in relevant financial business involving virtual assets for or on behalf of a third party. Under the FATF Guidance, this can even extend to software developers if they are paid to deploy programs on behalf of customers which offer virtual asset services (although writing and developing the software itself will not be a virtual asset service) and those who offer virtual asset services for direct or indirect profit, even if an element of the service is decentralised or runs through a smart contract. Similarly, the FATF explicitly does not seek to regulate as VASPs those who provide ancillary services or products to a virtual asset network, such as ancillary services to hardware wallet manufacturers or non-custodial wallets, operators of validator nodes, miners and network infrastructure providers, even if such activities are conducted as a business.

Virtual assets themselves, and those using virtual assets or VASPs for their own private purposes or as principals, are not affected.

Registration and licensing requirements, fees, timings and consequences of non-compliance

All VASPs - including businesses acting as VASPs on an occasional or limited basis - must either be registered by or licensed with CIMA (or granted a waiver if an existing licensee) before any virtual asset operations can commence (including issuances).

VASPs already licensed under any other Cayman Islands regulatory laws may not need to be separately registered or licensed. However, they will need to notify CIMA of the details of their VASP activities under the VASP Act and their existing licence terms and the need for separate licensing or registration may be waived by CIMA on a discretionary basis.

The VASP Act licensing regime will not be live before July 2021. VASPs which would otherwise need a license before this date must apply to register with CIMA and have their registration application approved before commencing operations, then apply for a license from July 2021. We anticipate a transitional period during which VASPs may continue to operate without a license provided they are registered with CIMA and have submitted a license application on or before 1 July 2021.

All VASPs will be subject to ongoing requirements, including regulatory audits by CIMA, preparing audited financial statements, appointing and maintaining compliance officers, and obtaining CIMA's written approval before issuing or transferring equity interests representing 10 per cent or more of its total equity interests. Further requirements may also apply but are not yet published.

Registration process

VASPs seeking to register with CIMA must first comply with the Cayman Islands money laundering, countering the financing of terrorism, countering proliferation financing and sanctions regimes. This includes appointing natural persons to act as the VASP's anti-money laundering compliance officer, money laundering reporting officer and deputy money laundering reporting officer.

The registration application form or notification must be submitted to CIMA through its REEFS online portal. CIMA will require information as part of this application such as:

- Details of anti-money laundering compliance policies, procedures and appointments of officers
- Details of the virtual asset service
- Prior or forecasted revenue
- How the service will be provided to the public
- A risk identification and mitigation strategy

Fees

The application must be accompanied by a non-refundable assessment fee of approximately US\$1,220. There is then a registration fee when the application is accepted (assuming services are offered outside of Cayman (ie globally) as well as in Cayman) based on expected turnover:

- If the turnover is expected to be less than US\$600,000 per annum US\$3,100 to US\$6,200 depending on CIMA's assessment of the nature, scope and complexity of the applicant's business; or
- If the turnover is expected to be more than US\$600,000 per annum then the range is US\$9,146 – US\$18,500 based on the same assessment regarding nature, scope and complexity.

There will also be an annual fee payable to CIMA which will be in an amount equal to the final application fee.

Timings

A Cayman VASP vehicle must be formed and comply with regulatory and economic substance requirements before it can submit a VASP registration or licensing application.

Timing for the registration or licensing process itself is difficult to estimate. Assuming a well-founded and complete application, a full licence process could take up to 9 months from submission to CIMA. A similarly complete registration application could take up to around 6 to 12 weeks from submission to approval. Any information requests or queries from CIMA could increase the time taken to successful approval of an application.

Offences and penalties

It is a criminal offence for a VASP which is either: (a) not registered as a VASP with CIMA; or (b) is an existing licensee that isn't granted a waiver, to carry on a virtual asset service in or from within the Cayman Islands which requires registration. The VASP which fails to register with CIMA is liable on conviction to a fine of up to US\$30,500.

Where an offence is committed by a VASP and it is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of any senior officer of the VASP, or any person who was purporting to act in any such capacity, that person as well as the VASP itself commits the offence, and that person is liable to a separate fine of up to US\$30,500, as well as up to one year's imprisonment. If the VASP is managed by its members, a relevant member commits the offence in connection with its management functions as if that member were a senior officer of the VASP.

Is an investment fund investing in virtual assets and/or issuing tokenised interests a VASP?

Investment funds which invest in virtual assets and do not issue tokenised equity interests (such as shares or limited partnership interests) are unlikely to be VASPs, but will be subject to regulation under the Private Funds Act (2021 Revision) or the Mutual Funds Act (2021 Revision). While we wait for guidance from CIMA on the issue, investment funds which intend to issue tokenised equity interests will be undertaking a virtual asset issuance, which is VASP activity, and may need to either notify CIMA or be registered as a VASP with CIMA prior to launch. Funds wishing to accept subscriptions in virtual assets or make redemptions in-kind using virtual assets must take structuring advice to determine whether they or their service providers may fall within the framework.



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