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FinTech

Cayman Islands: Law & Practice
Walkers

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Law and Practice

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Walkers is a leading international firm that provides legal, corporate and fiduciary services to global corporations, financial institutions, capital markets participants and investment fund managers. Clients are Fortune 100 and FTSE 100 companies as well as the most innovative firms and institutions across the financial markets. The firm has ten offices, in Bermuda*, the British Virgin Islands, the Cayman Islands, Dubai, Guernsey, Hong Kong, Ireland, Jersey, London and Singapore. It advises businesses partnering with or investing in FinTech firms as well as financial institutions and asset managers developing their own FinTech products and services. The FinTech group, which consists of 14

partners and 17 other qualified lawyers globally, also works closely with policymakers, regulators and governments to facilitate appropriate legislation and regulation that keeps pace with innovation. Walkers covers FinTech's core financial industry sectors – asset management, investment, banking, finance, insurance and payments – with particular expertise of advising businesses specialising in blockchain, digital assets and alternative model finance.

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Authors



Melissa Lim is a partner based in the Cayman Islands office in the global investment funds group and a member of the FinTech team. She has extensive experience in a broad range of investment fund structures, including private equity

funds, hedge funds, technology and venture capital funds, cryptocurrency funds and unit trusts. An integral part of her practice involves advising in relation to M&A, joint ventures, preference share issues, corporate restructurings, other corporate transactions and FinTech transactions, including blockchain projects and digital assets. She is a non-executive director of the Cayman Islands Utility Regulation and Competition Office (which regulates utilities, fuels and T&T sectors of the Cayman Islands), a member of the Cayman Islands Financial Services Legislative Subcommittee for FinTech (which is drafting the FinTech legislation for the Cayman Islands) and a member of the Cayman Islands Monetary Authority Digital Assets Working Group. Melissa is in the process of being appointed a director to the Blockchain Association of the Cayman Islands.



Lucy Frew is the global head of the regulatory and risk advisory practice group in the Cayman Islands office, Lucy is also a member of the FinTech team and has more than 17 years' experience as a specialist financial regulatory and risk

management advisory lawyer. Her clients are financial institutions across the international and domestic spectrum, including banks, investment funds, administrators, investment managers, advisers, broker-dealers, arrangers, trading venues, and insurance and reinsurance sector clients. Lucy also offers significant experience in advising on FinTech. Typical matters range from strategic advice, regulatory gap analysis and regulatory impact assessments to the full range of financial regulatory applications and notifications, as well as areas

such as day-to-day financial regulatory compliance, anti-money laundering and counter-terrorist financing requirements, the Common Reporting Standard (CRS) and the Foreign Account Tax Compliance Act (FATCA). She is a member of the Cayman Finance Smart FinTech Regulations Subcommittee, the Cayman Finance Digital Funding and Investing Subcommittee, and the Cayman Islands Financial Services Legislative Subcommittee for Fintech.



Tony De Quintal is a senior counsel based in the Cayman Islands office in the regulatory and risk advisory group, and a member of the FinTech team. He specialises in financial services regulatory law and risk management, and has more

than 18 years' experience, including more than nine years working for the FSA in the United Kingdom (now the Prudential Regulation Authority) and the Cayman Islands Monetary Authority. Prior to joining Walkers, Tony was global general counsel of an international FinTech operating in Europe, the USA, Canada, and Central and South America. He led the legal and regulatory/compliance function for the international payment services business and its associated FinTech developments, payment systems and processes, payments network and prepaid cards. Tony is an accredited director of the Institute of Chartered Secretaries Canada and a solicitor on the Cayman Islands Legal Practitioners Association.



Tom Hagger is an associate based in the Cayman Islands office in the global investment funds group. He regularly advises asset managers and their onshore counsel in relation to a wide range of corporate and partnership issues. Tom is

also a member of the FinTech team with a particular focus on cryptocurrency funds, blockchain products and virtual currencies.

1. FinTech Market

1.1 Evolution of the FinTech Market

The FinTech market in the Cayman Islands has developed over the last twelve months to build a technology talent pool and an increasingly mature technology industry to develop and strengthen the financial services industry of the Cayman Islands. The Cayman Islands is the leading offshore jurisdiction for investment funds, one of the top financial centres of the world and a world leader in structured finance, and its government has been positive about encouraging FinTech in the financial services industry. It has been a busy twelve months of the Cayman Islands government embracing technology in its processes and services, the Cayman Islands government encouraging technology companies to move to the Cayman Islands and develop a technology industry in the Cayman Islands, and the Cayman Islands financial services regulator (the Cayman Islands Monetary Authority, or the Authority) and technology regulator (the Utility Regulation and Competition Office, or OfReg) educating themselves about blockchain, smart contracts and cryptocurrencies.

The Special Economic Zone (SEZ) was introduced by the Cayman Islands government to encourage the development of certain industries in the Cayman Islands, including technology by granting certain incentives for technology companies to relocate physically to the Cayman Islands and to work in the Cayman Islands. The SEZ now has over 250 companies, including approximately 60 blockchain-focused companies.

Given the proximity to the USA, the similar time zone to the USA, the established reputation of the Cayman Islands as a financial services capital and the increasing difficulty in obtaining visas in the USA, some technology companies have opened offices in the Cayman Islands and have located their employees in the Cayman Islands.

In addition to the SEZ, TechCayman was established in August 2018 to encourage technology entrepreneurs to establish their businesses in the Cayman Islands and to create a hub whereby the technology community can come together to collaborate and build new programmes and ecosystems.

In August 2017, the IP legislation in the Cayman Islands was updated to strengthen and protect IP rights, and now permits direct registration of IP rights in the Cayman Islands rather than via the United Kingdom.

The Cayman Islands government has also established an e-government unit responsible for transitioning manual and paper-based governmental services to an electronic and online system to follow the Estonia model. This process is ongoing and it is considering all forms of technology from

blockchain to digital ID to automate governmental processes and services.

The need to increase the local talent pool to service the technology industry has come to the attention of the Cayman Islands government and it is in the process of establishing women and youth coding programmes. The University College of the Cayman Islands has also launched coding programmes in 2019 due to the demand for such courses.

The Cayman Islands regulators are continuing their focus on blockchain and digital assets after the run-up in prices of cryptocurrencies in 2017. The Authority established a working group in March 2018 to get up to speed with understanding digital assets and how best to regulate these assets. OfReg is encouraging the development of blockchain projects by considering and proposing changes to the Cayman Islands Electronic Transactions Law to incorporate express recognition of blockchain and smart contracts.

Whilst the development of a regulatory regime that aims to regulate digital asset-related business in a workable and appropriate manner is expected, following the crypto winter, many Cayman Islands companies who held large portions of their worth in crypto assets may become unable to meet their liabilities as they fall due and fulfil the promises they made to investors (token purchasers and otherwise). When this happens, and consequent disputes arise, creditors, contributories and other interested parties will need to evaluate their options and the recourse available to them from a dispute resolution and insolvency perspective. Fortunately, the Cayman Islands has a robust and predictable legal regime that can assist such parties in enforcing rights they may have against the company, although this new asset class demands service providers who truly understand the technology that underpins the operation of such assets to provide effective advice and services.

2. FinTech Verticals

2.1 Predominant Business Models

With respect to this firm's selected vertical of blockchain, Cayman Islands vehicles' involvement in blockchain is typically as crypto funds, funds investing in blockchain projects, token issuers in the context of security token offerings (STOs) or initial coin offerings (ICOs), joint-venture vehicles developing blockchain projects, service-providers such as broker-dealers and custodians, and IP holding vehicles. There are no legacy players as such as this is a relatively new industry.

2.2 Regulatory Regime

The financial services sector in the Cayman Islands is regulated by the Authority, which receives its supervisory powers from the Monetary Authority Law (MAL). In summary,

the regulatory laws provide for a licensing process whereby entities and individuals conducting regulated activity are required to obtain a licence or be registered with the Authority to conduct the regulated activities.

The Authority supervises the regulated entities and individuals through its supervisory process and powers emanating from the MAL. This supervisory oversight includes desk-based supervision and on-site inspection. The Authority also has supervisory oversight over the anti-money laundering (AML) practices of entities within the scope of the Cayman Islands AML regulations.

There are a number of legislative obligations that are required to be considered alongside the regulatory laws, including the beneficial ownership regime and Automatic Exchange of Information (AEOI).

The Cayman Islands currently does not have legislation or regulation specific to digital assets, payments and products such as digital currencies, blockchain-based tokens and blockchain coins (together, Digital Assets). However, the Cayman Islands government recently announced a framework to be adopted to promote and regulate new financial technologies, including Digital Assets. Refer to **2.4 Regulatory Sandbox** for the details on the regulatory sandbox to be adopted.

2.3 Variations Between the Regulation of FinTech and Legacy Players

The Authority does not differentiate between FinTech participants and legacy participants. The Authority's licensing structure applicability centres on the activities conducted by the participant. A FinTech participant shall fall within the Authority's regulatory scope if it conducts a licensed activity.

2.4 Regulatory Sandbox

The Cayman Islands government recently announced a framework to be adopted to promote and regulate new financial technologies, including Digital Assets. The government has proposed an adaptable, technology-neutral, regulatory sandbox-type framework that welcomes new and existing, innovative and pioneering businesses, and that provides sufficient oversight and monitoring to ensure the activities taking place are compliant, fair and transparent. It is understood that this versatile approach would be intended to allow the Authority to observe new ideas, understand them, shape them if appropriate and generate insights to feed back into mainstream regulatory activities.

The Cayman Islands government believes that a regulatory sandbox – while welcoming new and existing, innovative and pioneering companies – provides sufficient oversight and monitoring to ensure the activities taking place are compliant, fair and transparent. This versatile approach would allow a regulator to observe new ideas, understand them,

shape them if appropriate and generate insights to feed back into mainstream regulatory activities. It will encourage, foster and incubate legitimate activities while adapting the laws and regulations of the Cayman Islands on an ongoing basis as the need arises. The Cayman Islands government is collaboratively engaged in the process of developing the necessary legislative changes to implement this regulatory sandbox.

2.5 Jurisdiction of Regulators

The Authority regulates the financial services industry in the Cayman Islands and has four principal functions:

- *Monetary* – the issue and redemption of Cayman Islands currency and the management of currency reserves.
- *Regulatory* – the regulation and supervision of financial services, the monitoring of compliance with money laundering regulations, the issuance of a regulatory handbook on policies and procedures, and the issuance of rules and statements of principle and guidance.
- *Co-operative* – the provision of assistance to overseas regulatory authorities, including the execution of memoranda of understanding to assist with consolidated supervision.
- *Advisory* – the provision of advice to the government on monetary, regulatory and co-operative matters.

Among the Authority's obligations in carrying out its functions are the requirements to:

- act in the best economic interests of the Cayman Islands;
- promote and maintain a sound financial system in the Cayman Islands;
- use its resources in the most efficient and economical way;
- have regard to generally accepted principles of good corporate governance;
- endeavour to promote and enhance market confidence, consumer protection and the reputation of the Cayman Islands as a financial centre;
- reduce the possibility for the use of financial services business for money laundering or other crime;
- recognise the international character of financial services/markets and the need to be competitive for consumers and suppliers while complying with appropriate and relevant international standards;
- recognise the principle that a burden or restriction that is imposed should be proportionate to its expected benefits;
- recognise the desirability of facilitating innovation in financial services business; and
- be transparent and fair.

The Tax Information Authority (TIA) is established by the Tax Information Authority Law (the TIA Law) and is the Cayman Islands competent authority for the purposes of international assistance in tax matters.

The overriding objective of the Department for International Tax Cooperation (DITC) is to carry out the lawful and effective implementation of Cayman's international co-operation arrangements in tax matters. With separate statutory schemes governing TIA on the one hand and AEOI on the other, the DITC carries out its responsibilities in a separate and distinct manner in these two areas of activity.

The DITC operates in an open, transparent and accountable manner, whilst having due regard for the highly confidential nature of the detailed information that it is responsible for handling. These important principles ensure that the international obligations of the Cayman Islands are honoured and that the DITC effectively maintains integrity in the performance of its statutory functions, engenders and preserves the confidence of the public and the financial services community in its work, and meets its obligations to foreign counterpart authorities.

The TIA is also the relevant authority for the International Tax Cooperation (Economic Substance) Law (the Economic Substance Law) in determining whether a relevant entity satisfies the economic substance test in respect of its relevant activities. The types of relevant activities that fall within the Economic Substance Law include holding company business and intellectual property (IP) business.

The Office of the Ombudsman (the Ombudsmen) is the supervisory authority for data protection-related matters. The Ombudsmen is empowered as an independent office of the legislature to investigate, mediate and decide complaints under the Data Protection Law, 2017 (DPL) commencing 30 September 2019, when the DPL comes into force.

2.6 Outsourcing of Regulated Functions

The Authority provides guidance to regulated entities on the establishment of outsourcing arrangements and the outsourcing of material functions or activities (Guidance). The Guidance is provided on the basis that regulated entities remain ultimately responsible for all outsourced material functions or activities, regulatory requirements and any other requirements of the Authority.

The Guidance stipulates that a regulated entity should assess the materiality of its outsourcing arrangements, considering the impact of the outsourcing on the regulated entity, and its risk management structure and internal controls. The Guidance further requires that a regulated entity should maintain the same level of oversight and accountability with respect to the outsourcing of any material function or activity as it would apply to its non-outsourced material functions or activities.

The Authority requires that a regulated entity's relationship and obligations towards its clients must not be altered as a result of the outsourcing of any material function or activity.

In addition, a regulated entity's level of net risk should not materially increase as a result of outsourcing compared to if it carried out the material function or activity itself.

Where a regulated entity intends to outsource a function, it should perform, document and maintain as part of its records a due diligence assessment of a service provider before entering into the initial outsourcing agreement and on a regular basis thereafter to ensure that the service provider is fit and proper, and can effectively perform the outsourced material function or activity, and to ensure high ethical and professional standards. Lastly, a regulated entity should have a detailed, legally binding, written outsourcing agreement or contract in place for all material outsourcing arrangements irrespective of whether such arrangements are with related or unrelated parties.

2.7 Significant Enforcement Actions

As Digital Assets are currently not regulated, the Authority does not have enforcement powers over Digital Assets unless they fall within a regulated activity. To date, the Authority has not taken any enforcement actions in the Digital Assets space.

2.8 Implications of Additional Regulation

The Cayman Islands AML Regulations require entities that conduct 'relevant financial business' to comply with the AML Regulations.

The Cayman Islands also has data protection legislation, the DPL, that is effective from 30 September 2019 and requires entities within the scope of the legislation to comply with the data protection principles defined in the legislation.

The DPL requires a data controller to comply with eight data protection principles when processing personal data and to ensure that those principles are complied with in relation to personal data processed on the data controller's behalf pursuant to a written contract. The DPL also deals with data security, data breaches and the rights of individual data subjects, including providing a privacy notice.

The DPL applies to personal data processed by "data controllers" and "data processors." Financial sector entities established in the Cayman Islands will generally be data controllers, data processors or both. The DPL applies to processing carried out by data controllers established within the Cayman Islands. In certain cases, it applies to data controllers outside the Cayman Islands that process personal data within the Cayman Islands.

The Utility Regulation and Competition Office has been given the remit by the Cayman Islands government to regulate cybersecurity and it has proposed a Cyber Law. The draft of such law is not yet available.

2.9 Regulation of Social Media and Similar Tools

The use of social media and similar tools is currently not regulated apart from previously defined legislation such as the DPL.

2.10 Review of Industry Participants by Parties Other Than Regulators

Cayman Islands-based service providers (eg, auditors or administrators) to Digital Assets entities are required to comply with Cayman Islands law. If any person who is resident in the Cayman Islands has a suspicion that a transaction involving a Cayman Islands entity (by way of subscription or otherwise) contains the proceeds of criminal conduct, that person is required to report such suspicion pursuant to the Proceeds of Crime Law (as amended).

A blockchain association is currently being established in the Cayman Islands with the aim of facilitating collaboration in the industry, creating guidelines for the industry, and lobbying the Cayman Islands government and the regulators to encourage the development of the industry.

2.11 Conjunction of Unregulated and Regulated Products and Services

The offering of Digital Assets is currently not regulated unless the activity falls within the definition of financial services business that is currently regulated. Where an entity's activities fall within the scope of the regulated activities, its operations will be subject to supervision by the Authority.

If the product is the offering of equity interests in an investment fund investing in cryptocurrencies and permits the redemption of equity interests at the option of the investors, the investment fund is typically structured as a Cayman Islands exempted company or Limited Liability Company. If the investment fund is investing in long-term blockchain projects and does not permit the redemption of equity interests at the option of the investors, the investment fund is typically structured as a Cayman Islands exempted limited partnership.

If the product is a securities token offering, a preferred vehicle appears to be a Cayman Islands foundation company due to historical reasons of Swiss foundations being used as the token issuers.

If it is proposed that parties engage in a joint venture to develop a blockchain product, the joint-venture vehicle is typically structured as a Cayman Islands limited liability company due to the ease of combining the shareholder arrangements within the limited liability company agreement whilst having a corporate form.

3. Robo-advisers

3.1 Requirement for Different Business Models

The Cayman Islands legislation does not expressly contemplate robo-advisers. To the extent that a legal entity holds the algorithm or software that provides the robo-advisers function and that legal entity is a Cayman Islands entity or a non-Cayman Islands entity registered in the Cayman Islands, it will be required to be registered or licensed under the Securities Investment Business Law (SIBL).

3.2 Legacy Players' Implementation of Solutions Introduced by Robo-advisers

This firm is not aware of any Cayman Islands service providers introducing robo-advisers at this stage. However, there have been instances of Cayman Islands entities being managed by entities relying on proprietary robo-advice algorithms or licensed software.

4. Online Lenders

4.1 Differences in the Business or Regulation of Loans Provided to Different Entities

The business of loans to individuals is currently not regulated. However, the provision of loans is within the scope of the AML Regulations, which does not distinguish between the recipients of the loans.

4.2 Underwriting Processes

The underwriting process is currently not regulated in the Cayman Islands. Instead, the Authority will require the lenders to be in compliance with the laws of the jurisdiction in which the underwriting is taking place (which is typically located onshore and not in the Cayman Islands).

4.3 Sources of Funds for Loans

Retail lending to Cayman Island residents is primarily conducted by Class A-licensed Cayman Islands banks who are conducting banking business that is regulated by the Authority. The source of funds for this lending stems from the deposits received from the Class A-licensed Cayman Islands banks.

In terms of sources of funds for loans to Cayman Islands entities, the Cayman Islands is viewed by lenders as a creditor-friendly jurisdiction. Lenders are able to enforce their security without going to the Cayman Islands courts; the Cayman Islands courts have a separate financial services division that specifically deals with financial services disputes and the Cayman Islands has an established legal system based on English common law. Accordingly, there is a healthy appetite for banks to lend to Cayman Islands entities. Borrowing by Cayman Islands entities is not currently regulated in the Cayman Islands.

Credit funds are increasingly popular with investors as they present a steady income. Accordingly, this firm has formed many Cayman Islands credit funds and this has been one of the most popular investment strategies for investment funds for the last few years, which appears still to be going strong. Cayman Islands credit funds are providing a much needed source of funding as the traditional banks reduce their lending. Lending by Cayman Islands entities is not currently regulated in the Cayman Islands.

Securitisations have also come back strongly in the last five years and Cayman Islands vehicles in the form of exempted companies or limited liability companies are typically used as the issuers. Various income streams have been securitised, including real estate mortgages and aviation leasing streams. Cayman Islands securitisation vehicles are not currently regulated in the Cayman Islands.

Peer-to-Peer lending is not currently regulated in the Cayman Islands.

4.4 Syndication of Loans

The syndication of loans takes place onshore rather than in the Cayman Islands. Accordingly, to the extent that the Cayman Islands lending vehicle is involved in a syndication, it must be in compliance with the laws of the onshore jurisdiction.

5. Payment Processors

5.1 Payment Processors' Use of Payment Rails

Payment processors must use existing payment rails at this stage. However, with the introduction of a regulatory sandbox in the Cayman Islands in the near future, it is expected that new and innovative payment rails such as payment in cryptocurrencies will be available.

6. Fund Administrators

6.1 Regulation of Fund Administrators

Cayman Islands-based administrators must hold a licence pursuant to the Mutual Funds Law (the MF Law), which requires a Cayman Islands-licensed mutual fund administrator to satisfy itself as to various criteria regarding the business and operation of a mutual fund and its service providers before it provides fund administration to a mutual fund.

6.2 Contractual Terms

There are a number of provisions being incorporated into fund administration documents, many of which stem from regulatory obligations and in particular the the AML Regulations. Essentially, fund administration agreements include provisions requiring the administrator to provide information and documentation relevant to AML requirements to

the regulated fund itself or the Authority. The AML Regulations also require the fund administrator to maintain records of AML documentation for at least five years after conclusion of the transaction. These agreements also require the administrator to report any suspicions it may have relating to money laundering potentially occurring through the fund to the fund's money laundering reporting officer.

In addition to AML requirements, the fund administration agreement will often have provisions requiring the administrator to safeguard and treat personal data in accordance with certain prescribed standards.

6.3 Fund Administrators as 'Gatekeepers'

A Cayman Islands-licensed mutual fund administrator has certain report to obligations to the Authority under the MF Law regarding the operations of a fund that it administers. If a licensed mutual fund administrator knows or has reason to believe that a mutual fund for which it provides services (i) is or is likely to become unable to meet its obligations as they fall due, (ii) is carrying on business otherwise than in accordance with any laws or (iii) is carrying on business in a manner that is or is likely to be prejudicial to investors or creditors of the fund, it must immediately give the Authority written notice of its knowledge or belief, giving its reason for that knowledge or belief, and any mutual fund administrator who contravenes these requirements is liable for a fine of KYD200,000.

7. Exchanges and Trading Platforms

7.1 Permissible Trading Platforms

Under the Stock Exchange Company Law of the Cayman Islands, the Cayman Island Stock Exchange (CSX) has the sole and exclusive right to operate one or more securities markets in the Cayman Islands. 'Securities markets' is defined as a stock market or a place where, or facility or arrangement by which (and situated in whole or in part in the Cayman Islands), securities are listed, regularly offered for purchase or sale, or by reference to which transactions in securities are regularly entered into by or on behalf of competing buyers. In light of such broad definition, the only trading platform for securities in the Cayman Islands is the CSX. It is expected that the proposed regulatory sandbox will permit the introduction of other securities exchanges or platforms particularly for Digital Assets.

7.2 Regulation of Different Asset Classes

See 7.1 Permissible Trading Platforms.

7.3 Impact of the Emergence of Cryptocurrency Exchanges

See 7.1 Permissible Trading Platforms.

7.4 Listing Standards

The CSX has published listing rules that are applicable for listing of securities on the exchange. There are no separate industry standards for listing on the CSX.

7.5 Order-handling Rules

There are no order handling rules in the Cayman Islands.

7.6 Rise of Peer-to-Peer Trading Platforms

See 7.1 Permissible Trading Platforms. There are no peer-to-peer trading platforms in the Cayman Islands.

8. High-frequency and Algorithmic Trading

8.1 Creation and Usage Regulations

There are currently no regulations in the Cayman Islands specifically regulating the creation and usage of high-frequency and algorithmic trading; however, such activities fall within the definition of financial services business and therefore are subject to supervision by the Authority. There are businesses established in the Cayman Islands that are conducting high-frequency and algorithmic trading; however, these are rare as the broadband speeds are relatively slower compared to the USA. The Cayman Islands Utility Regulation and Competition Office is currently seeking expressions of interest for new submarine cables to connect to the Cayman Islands to increase broadband speeds as the existing submarine cables are nearing end of life.

8.2 Exchange-like Platform Participants

See 8.1 Creation and Usage Restrictions. There are no exchange-like platforms in the Cayman Islands as the CSX has the sole and exclusive right to operate securities markets in the Cayman Islands.

8.3 Regulatory Distinction Between Funds and Dealers

Cayman Islands-domiciled investment funds that engage in these activities will need to be registered as mutual funds under the Mutual Funds Law if they are open-ended funds. Cayman Islands-domiciled investment managers for such funds will need to be registered or licensed under the SIBL.

9. Financial Research Platforms

9.1 Registration

The Cayman Islands-domiciled operators of financial research platforms are not subject to registration unless the platforms also provide investment advice, in which case the operator of the platform will need to be registered or licensed under the SIBL.

9.2 Regulation of Unverified Information

There are no securities laws in the Cayman Islands. Accordingly, the spreading of rumours and other unverified information is not regulated in the Cayman Islands. The Authority would require the Cayman Islands-domiciled operator of such platform to comply with the laws of the jurisdiction in which the platform is operating.

9.3 Conversation Curation

See 9.2 Regulation of Unverified Information.

9.4 Platform Providers as ‘Gatekeepers’

Cayman Islands-based service providers are required to comply with Cayman Islands law. If any person who is resident in the Cayman Islands has a suspicion that a payment to a Cayman Islands entity (by way of subscription or otherwise) contains the proceeds of criminal conduct, that person is required to report the suspicion pursuant to the Proceeds of Crime Law (as amended).

10. InsurTech

10.1 Underwriting Processes

Whilst InsurTech has been recognised as an important part of the discussion on the development of the insurance industry in the Cayman Islands, this firm is not aware of any specific and material InsurTech underwriting initiatives or developments.

10.2 Treatment of Different Types of Insurance

Any person carrying on insurance business, reinsurance business or business as an insurance agent, insurance broker or insurance manager in or from the Cayman Islands is required to hold a valid licence issued for that purpose under the Insurance Law. As set out in further detail below, domestic insurers offer insurance to Cayman Islands residents and businesses under a Class A licence. The non-domestic market comprises both insurers that insure non-domestic risks under a Class B licence and insurance-linked securities structures under a Class C licence. Reinsurers offer reinsurance products for domestic or foreign risks under a Class D licence.

11. RegTech

11.1 Regulation of RegTech Providers

RegTech providers will become regulated depending on their activities. Where an entity’s activities fall within the scope of the regulated activities, its operations will be subject to supervision by the Authority.

11.2 Contractual Terms to Assure Performance and Accuracy

There are a number of provisions being incorporated into contracts with technology providers. The key provisions generally relate to protection of IP rights and confidentiality. The contracts will often have provisions requiring the technology providers to safeguard and treat personal data in accordance with certain prescribed standards under data protection laws.

11.3 RegTech Providers as ‘Gatekeepers’

Cayman Islands-based service providers are required to comply with Cayman Islands law. If any person who is resident in the Cayman Islands has a suspicion that a payment to a Cayman Islands entity (by way of subscription or otherwise) contains the proceeds of criminal conduct, that person is required to report the suspicion pursuant to the Proceeds of Crime Law.

12. Blockchain

12.1 Use of Blockchain in the Financial Services Industry

There are no legacy players in the Cayman Islands and therefore the implementation and thought leadership relating to blockchain in the financial services industry is being driven by new players and certain existing service providers. Despite the lack of legacy players and the Cayman Islands not yet having a dedicated blockchain statutory and regulatory regime, the jurisdiction is at the forefront of the FinTech ‘revolution’. It is one of the leading jurisdictions for STOs based on funding volume and has seen a wide range of investment funds focusing on blockchain-related investments. These funds have been established in the hedge fund and venture capital space, using exempted company, exempted limited partnership and limited liability company vehicles. This is testament to the Cayman Islands’ well-tested structures with which managers and investors are familiar and comfortable.

The legal and regulatory framework in the Cayman Islands is designed to facilitate growth and enterprise, and to provide a flexible business environment. One example of how the Cayman Islands government is helping to facilitate the growth of FinTech business in the Cayman Islands is the Cayman Tech Zone housed within the Cayman Enterprise City. This is a Special Economic Zone that has been established to encourage technology businesses from start-ups through to established players to come and do business in the Cayman Islands. Many of its current members are developing cutting-edge software including blockchain and they have found that having their IP offshore and operating from a tax-neutral platform has not only made them more profitable, but has also accelerated rapid growth.

12.2 Local Regulators’ Approach to Blockchain

At the time of writing, there is no legislation or guidance issued with respect to blockchain by the Authority.

The Authority has established an internal digital assets working group comprising of representatives of the Authority, the Cayman Islands Ministry of Financial Services and the Department of Commerce and Investment, and Walkers as the sole industry representative. The current intention is for a draft consultation paper on the regulation of digital assets to be available by June 2019.

In late 2018 the Authority also indicated that it is keen to explore the possibility of implementing a regulatory sandbox for digital assets and other types of financial technologies, including blockchain. This idea is inspired by the United Kingdom’s Financial Conduct Authority (FCA), which introduced its own regulatory sandbox in 2015. A regulatory sandbox is a ‘safe space’ in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity in question. This concept is seen by the Authority as a way for it to work with FinTech businesses to ensure that any legislation or guidance that it does ultimately pass is flexible and business friendly.

12.3 Classification of Blockchain Assets

There is no formal guidance on whether the Authority considers blockchain assets a form of regulated financial instrument.

The Authority has indicated that it may consider the SEC’s Howey test on whether a token is considered a security. The FCA is consulting on guidance on when a token may be considered a security token, which the Authority may also take into account. The Authority has also indicated that to the extent that the tokens are issued by the token issuer to raise funds for the purposes of developing the technology platform, this is likely to mean that the token is a security.

At this time it is not possible to say definitively how the remainder of potential blockchain assets will be regulated in the Cayman Islands.

12.4 Regulation of ‘Issuers’ of Blockchain Assets

The Authority has released a public advisory on virtual currencies to warn of the risks associated with investments in ICOs and virtual currencies, and sets out some of the red flags potential investors should look out for to help to identify potentially fraudulent ICOs.

To the extent that a blockchain asset is characterised as a security under Cayman Islands law, the issuer will need to conduct AML due diligence on all holders of the blockchain asset and all subsequent transferees of the blockchain asset.

The AML standards to be applied must be the Cayman AML Regulations unless the issuer delegates the AML due diligence to a regulated third-party AML provider situated in a jurisdiction listed in the Cayman Islands AML Steering Group List of Equivalent Jurisdictions (which includes the USA) applying the AML standards of such 'equivalent jurisdiction'.

In addition, the Cayman Islands is traditionally an offshore investment fund jurisdiction targeting high net worth or sophisticated investors in onshore jurisdictions. Accordingly, to the extent that the blockchain asset is a security, it is likely that the Authority may require that such security be offered only to high net worth or sophisticated investors. No blockchain asset that is a security can be offered to the public in the Cayman Islands as the Companies Law of the Cayman Islands provides that an exempted company that is not listed on the CSX is prohibited from making any invitation to the public in the Cayman Islands to subscribe for any of its securities.

12.5 Regulation of Blockchain Asset-trading Platforms

Section 4 of the Stock Exchange Company Law of the Cayman Islands provides that the CSX has the sole and exclusive right to operate one or more securities market(s) in the Cayman Islands. The CSX currently does not have the functionality to trade blockchain assets; however, it is considering doing so.

If this rule is relaxed and it is possible for other players to establish trading platforms then if such blockchain assets are characterised as securities, the entity that runs the platform may possibly be engaging in securities investment business under the SIBL as it is making arrangements with a view to another person buying, selling or subscribing for securities. If the entity is engaging in securities investment business involving high net worth or sophisticated investors, it will need to be registered with the Authority under the SIBL. If the company is engaging in securities investment business involving non-high net worth or non-sophisticated investors, a much more strenuous regime of licensing will be required under the SIBL.

12.6 Regulation of Invested Funds

The regulation of invested funds will depend upon the structure of the investment fund.

If the fund is structured as an open-ended fund, usually as a Cayman Islands exempted company, it needs to be registered with the Authority. This structure is more common for those managers looking to pursue an investment strategy that focuses on trading in virtual currencies. These strategies tend to be more liquid in nature and investors are able to redeem their investment at their own initiative. These structures are therefore open-ended and similar to a traditional

hedge fund. To the extent that the equity interests of the fund are to be tokenised, the Authority would consider the fund still to be offering equity interests and therefore registration with the Authority will be required.

If the fund is structured as a closed-ended fund, usually as a Cayman Islands exempted limited partnership, there is no Authority registration required. This structure is more common for those managers looking to pursue an investment strategy that focuses on long-term investments in blockchain start-ups or projects. These strategies tend to be illiquid in nature and investors are unable to redeem their investment without the manager's consent. These types of funds are akin to a private equity or venture capital fund.

12.7 Virtual Currencies

There is no formal legislation or guidance on virtual currencies or blockchain assets.

12.8 Impact of Privacy Regulation on Blockchain

In line with international data protection principles and, in particular, the EU General Data Protection Regulation, which has extraterritorial impact on certain Cayman Islands entities, the DPL provides that a data controller must comply with the following eight data protection principles, which are expanded on in the DPL.

- *Lawfulness, fairness and transparency* – personal data shall be processed fairly. In addition, personal data may be processed only if at least one of a number of conditions for lawful processing is met. Data subjects also have the right to be informed.
- *Purpose limitation* – personal data shall be obtained only for one or more specified lawful purposes and shall not be further processed in a manner incompatible with that purpose or those purposes.
- *Data minimisation* – personal data shall be adequate, relevant and not excessive in relation to the purpose or purposes for which it is collected or processed.
- *Accuracy* – personal data shall be accurate and, where necessary, kept up to date.
- *Storage limitation* – personal data processed for any purpose shall not be kept for longer than is necessary for that purpose.
- *Data subject rights* – personal data shall be processed in accordance with the rights of data subjects under the DPL.
- *Integrity, confidentiality and security* – appropriate technical and organisational measures shall be taken against unauthorised or unlawful processing of personal data and against accidental loss or destruction of, or damage to, personal data.
- *Cross-border transfer* – personal data shall not be transferred to a country unless that country ensures an adequate level of protection for the rights and freedoms

of data subjects in relation to the processing of personal data.

The DPL's restrictions on data processing and cross-border transfer on one hand and blockchain's claims of transparency and immutability of data on the other create tensions that are as yet unresolved not only in the Cayman Islands but globally.

Walkers

190 Elgin Avenue
George Town, Grand Cayman
KY1-9001
Cayman Islands

Tel: +1 345 949 0100
Fax: +1 345 949 7886
Email: info@walkersglobal.com
Web: www.walkersglobal.com



13. Open Banking

13.1 Regulation of Open Banking

There are currently no regulations in the Cayman Islands with respect to open banking.

13.2 Concerns Raised by Open Banking

Banks and technology providers will need to comply with the DPL once in force. There are mechanisms available under the DPL that banks and technology providers may be able to utilise to enable compliance in the context of open banking.