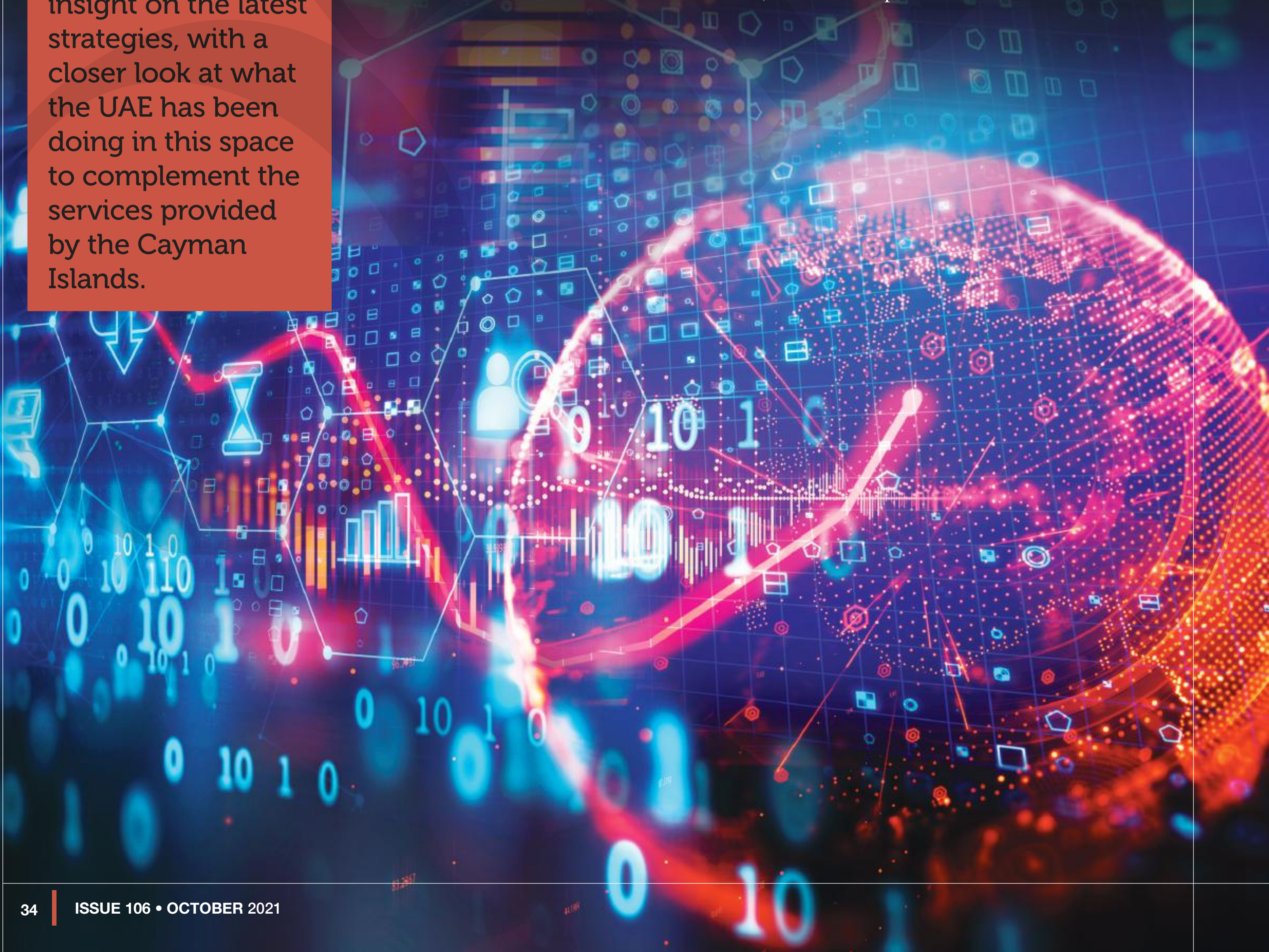
Offshore FinTech trends

The Cayman Islands has leveraged its position as an offshore funds jurisdiction to establish itself as an offshore Fintech hub. Walkers shares insight on the latest strategies, with a closer look at what the UAE has been doing in this space to complement the services provided by the Cayman Islands.

The UAE is taking FinTech seriously. Dubai and Abu Dhabi, and the DIFC and ADGM respectively, have implemented a wide range of initiatives and projects with the aim of growing FinTech in the UAE and the wider Middle East region. These initiatives include sandboxes and test licences for start-ups as well as the DIFC FinTech HUB, which is the first and largest FinTech accelerator in the region.

Arif Amiri, the chief executive of the DIFC, captured the essence of what the DIFC has to offer FinTech businesses when he remarked, "By giving FinTechs in the UAE a holistic, dynamic ecosystem with an independent regulatory and English Common Law judicial system and global financial exchange, start-ups can be better equipped to promote their innovative solutions and expansion plans to investors".

In our experience, such concentrated and strategic efforts to lure FinTech to the DIFC (and the UAE more broadly) have been successful in the short term, and provide a strong foundation for continued future growth in the sector in the medium to long term. As a top tier offshore law firm with



a full service offering in Dubai, we work regularly with a wide range of clients (and their onshore counsel) who require a mix of local or onshore legal services and offshore legal services.

For example, we have often seen asset managers basing themselves in the DIFC (and being appropriately DFSA regulated) when launching a fund with a FinTech and/ or Virtual Assets focused strategy. More recently, we have also seen significant growth in the establishment of ADGM domiciled, FSRA regulated asset managers.

For such managers, when considering the domicile of the relevant FinTech and/or Virtual Assets, the Cayman Islands is a clear market leader and the "default" choice in many cases. Pairing a Cayman Islands fund (which has the benefits of tax neutrality, cost-effectiveness, confidentiality, investor familiarity and broad flexibility) with the credibility associated with a DFSA or FSRA manager is often considered the "best of both worlds" approach, leveraging the respective benefits of the relevant offshore and onshore jurisdictions.

GENERAL TRENDS IN FINTECH

As Cayman Islands counsel in respect of many FinTech funds, we have seen first-hand the evolution of the strategies employed by these types of funds.

In 2017, the terms “Blockchain”, “Cryptocurrency” and “De-Fi” were not considered mainstream in the Cayman Islands or the UAE. In fact, it was only in 2017 that Walkers established its dedicated Global FinTech team. A lot has changed since then. Those terms have become part of everyday life and the media coverage dedicated to FinTech and Virtual Assets has grown significantly. During the same period the Cayman Islands and the UAE have established themselves as two of the leading global jurisdictions for conducting FinTech and Virtual Asset related business. Since 2017, we have seen an increasing number of Cayman Islands domiciled hedge funds trading in virtual assets and associated strategies including Decentralised Finance (“De-Fi”) – the rise of De-Fi has been particularly rapid and is considered in more detail below.

A recent report issued by PWC found that in 2021 the assets under management of hedge funds undertaking crypto strategies was USD3.8bn up from USD2bn in 2020. Whilst still dwarfed by the USD4,000bn of assets under management by traditional hedge funds in 2021 it is clear that the percentage of hedge fund assets under management dedicated to crypto strategies is steadily increasing. The increase year on year is another promising sign of the continued uptake and normalisation of crypto strategies and investments. The same report found that 34 per cent of funds specialising in these types of strategies were located in the Cayman Islands. This shows that the Cayman Islands is well positioned to benefit from the projected growth in this sector over the coming years.

Another recent report published by Intertrust found that 98 per cent of traditional hedge fund CFOs expected their hedge fund to be invested in cryptocurrencies within the next five years. This finding is further supported

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by the PWC report, which found that it is not just hedge funds with specialist crypto focused investment strategies who are allocating assets to crypto and crypto related strategies. More traditional funds and managers are starting to allocate a percentage of their funds under management to this sector.

THE RISE OF DE-FI

In addition to the theme of more traditionally minded managers experimenting with investments in crypto assets, we are seeing the more specialist crypto managers evolving their own strategies in an effort to stay ahead of the competition. We have seen an increase in De-Fi strategies and investments and some managers looking to launch funds with a De-Fi only strategy. The managers we have spoken to see De-Fi as presenting a unique set of opportunities with the potential for significant returns. The increased sophistication of the strategies being pursued correlates with the growing acceptance and mainstream understanding of blockchain and virtual assets.

Many people see De-Fi as one of the most promising and potentially disruptive uses of blockchain technology. It seeks to replace traditional financial systems with a peer to peer decentralised system with no intermediaries. De-Fi strategies engaged by Cayman Islands entities present some particular Cayman Islands regulatory questions to be considered including Cayman Islands AML rules, data protection, the VASP Act, the economic substance regime (particularly for lending platforms) and the Securities Investment Business Act. We have worked with clients to build robust policies and procedures and structures to mitigate potential risks in this evolving space.

THE CAYMAN ISLANDS AND THE VASP ACT

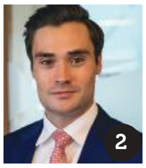
Over the past few years we have worked closely with clients, service providers, the Cayman Islands Monetary Authority and the Cayman Islands government to ensure that the Cayman Islands is the premier jurisdiction in which to conduct FinTech business. There are best in class service providers who have reacted quickly to strengthen their expertise across all areas of the sector.

In October 2020, the Cayman Islands government introduced the VASP Act, which provides a regulatory framework for virtual assets. The VASP Act was drafted with input from the industry, including Walkers, and the result is a piece of legislation which provides the requisite oversight required to regulate this industry but which is also able to accommodate and evolve with the innovative and changing landscape of this sector. The legislation has been well-received and we have worked with a wide range of clients who are seeking to establish Cayman Islands entities in connection with a range of virtual asset businesses. In our view, this is due in no small measure to the regulatory certainty afforded by the VASP Act.

CONCLUSION

In recent years, and as the Fintech revolution has continued to gain momentum, the Cayman Islands has leveraged its long-standing history as the premier offshore funds jurisdiction to strategically position itself as the premier offshore FinTech jurisdiction. At the same time, the UAE (and the broader Middle East region) has also been working hard to establish its own credentials in this space and to provide a compelling onshore offering to complement the offshore services provided by the Cayman Islands.

Both the Cayman Islands and the UAE are taking a pragmatic and sensible approach to regulation, which is helping to attract a wide range of Fintech business to both jurisdictions. In many cases, clients will need to utilise the services of both onshore and offshore jurisdictions to suit their particular needs. The opportunities in this space are vast, and it is an extremely exciting time for the sector. We are looking forward to working with our clients (and their onshore counsel) to help them seize those opportunities.



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