



RULE
**Obligations for the provision of virtual
asset services - Virtual Asset Custodians
and Virtual Asset Trading Platforms**

February 2022



Table of Contents

List of Acronyms	3
1. Introduction	4
2. Statement of Objectives	4
3. Statutory Authority	4
4. Scope of Application	4
5. Definitions	5
6. Governance	6
7. Conduct of Business	7
8. Prudential	10
9. Risk Management	12
10. IT and Cybersecurity	12
11. Virtual Asset Custody Service	12
12. Virtual Asset Trading Platforms	14
13. Reporting	16
14. Enforcement	16
15. Effective Date	16



List of Acronyms

IT	Information Technology
MAA	Monetary Authority Act
VASP	Virtual Asset Service Provider

FOR CONSULTATION



Rule – Virtual Asset Custodians and Virtual Asset Trading Platforms

1. Introduction

- 1.1. This document establishes the Cayman Islands Monetary Authority's (the "Authority") rules for virtual asset custodians and virtual asset trading platforms ("the Rule") licensed and regulated under the Virtual Asset (Service Providers) Act, 2020 (the "Act").

2. Statement of Objectives

- 2.1. To set out the Authority's rules applicable to licensed VASPs for the provision of virtual asset services, pursuant to the Monetary Authority Act ("MAA").
- 2.2. The measure is consistent with the Authority's statutory objectives as prescribed in the MAA, including to regulate and supervise financial services business carried on in or from within the Islands in accordance with the MAA and the regulatory laws and to promote and maintain a sound financial system in the Islands.

3. Statutory Authority

- 3.1. Section 34(1)(a) of the MAA provides that:

After private-sector consultation and consultation with the Minister charged with responsibility for Financial Services, the Authority may -

issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;

- 3.2. This Rule should be read in conjunction, where applicable, with all laws and regulatory measures addressing, anti- money laundering, the conduct of virtual asset services, ownership and control, fitness and propriety, internal controls, cybersecurity, business continuity management, corporate governance, outsourcing, nature, accessibility and retention of records, securities investment business, banks and trusts and any any other relevant laws and regulatory instruments issued by the Authority from time to time.

4. Scope of Application

- 4.1. This Rule applies to virtual asset custodians and virtual asset trading platforms licensed and regulated by the Authority. For the purpose of this Rule, virtual asset custodians and virtual asset trading platforms are entities licensed and regulated under the Act.
- 4.2. This Rule outlines the ongoing regulatory obligations of virtual asset custodians and virtual asset trading platforms in their conduct of virtual asset services.



5. Definitions

5.1. For the purpose of this Rule, any definition used is the same as assigned within the Act, unless otherwise specified below.

5.2. The following definitions are provided for the purpose of this Rule:

“bank” means a person carrying on banking business, as defined under the Banks and Trust Companies Act (as amended)

“client” means a legal or natural person to whom virtual asset services are provided;

“governing body” means the Board of Directors where the entity is a corporation, the General Partner where the entity is a partnership, the manager where the entity is an LLC, or equivalent;

“licensed VASP” means a virtual asset custodian or virtual asset trading platform;

“virtual asset custodian” means a licensee under section 8 of the Act who provides virtual asset custody services in or from within the Cayman Islands;

“virtual asset custody service” means the business of safekeeping or administration of virtual assets or the instruments that enable the holder to exercise control over virtual assets; and

“virtual asset trading platform” means a centralized or decentralized digital platform

(a) which facilitates the exchange of virtual assets for fiat currency or other virtual assets on behalf of third parties for a fee, commission, spread or other benefit; and

(b) which —

(i) holds custody of or controls virtual assets on behalf of its clients to facilitate an exchange; or

(ii) purchases virtual assets from a seller when transactions or bids and offers are matched in order to sell them to a buyer; and

(c) which is licensed under section 8 of the Act,

and includes its owner or operator, but does not include a platform that only provides a forum where sellers and buyers may post bids and offers and a forum where the parties trade in a separate platform or in a peer-to-peer manner.

For the purpose of the definition of **“virtual asset trading platform”**, where a single entity or group that controls the platform cannot be identified, the

operator of the platform shall be deemed the owner of the entity under which the platform operates.

6. Governance

- 6.1. Licensed VASPs must be led by a governing body made up of individuals who are suitably qualified and have the requisite skills, knowledge, and expertise for the role and which have been assessed by the Authority as being fit and proper.
- 6.2. The governing body of a licensed VASP must:
 - a) establish and implement governance arrangements to effectively oversee and operate the licensed VASP;
 - b) promote and contribute to the implementation of appropriate culture, corporate values, and behaviours within the licensed VASP;
 - c) ensure that it has appropriately considered and documented the roles and responsibilities of directors and senior officers in relation to succession planning, governing body composition, and capacity;
 - d) undertake an assessment of the performance, practical and professional experience, and suitability of directors and senior officers at least on an annual basis;
 - e) remain ultimately responsible for all outsourced functions or activities, and all legal and regulatory requirements; and
 - f) ensure that all employees have relevant experience and are suitably qualified, where appropriate, to carry out their respective roles.
- 6.3. The governing body must ensure that the licensed VASP performs periodic risk assessments considering all appropriate risks, including but not limited to, cybersecurity, AML/CFT, sanctions, custody, data protection and client protection or any other risks the governing body deems appropriate, and as required by law.
- 6.4. The number of individuals appointed to the governing body must be commensurate to the size, nature, and complexity of the licensed VASP's operations, provided that this number is not less than two.
- 6.5. Changes to the ownership (legal or beneficial), directors and senior officers require the Authority's prior written approval and are subject to an assessment of fitness and propriety.
- 6.6. The governing body must oversee and be accountable for governance arrangements that ensure effective and prudent management of the licensed VASP, including appropriate segregation of duties to prevent conflicts of interest, manipulation of financial data, or misappropriation of assets.

- 6.7. The governing body must document and undertake a regular review of the roles and responsibilities of senior management and other key employees in relation to the controls governing the segregation of duties.
- 6.8. Licensed VASPs must implement a governance framework that includes policies and practices on remuneration which promote sound and effective risk management, and not create incentives to relax risk standards.

7. Conduct of Business

Conflicts of interest

- 7.1. Licensed VASPs must maintain and implement effective policies to prevent, identify, manage, and disclose conflicts of interest.

Treating clients fairly

- 7.2. Licensed VASPs must act honestly, fairly, and professionally in accordance with the best interests of their clients and prospective clients.
- 7.3. Licensed VASPs must implement documented policies and procedures to ensure they are acting in the best interests of clients.
- 7.4. In dealing with clients and potential clients, licensed VASPs must act ethically and with integrity at all times.

Client communications and full disclosure

- 7.5. Licensed VASPs must provide clients with information that is fair, clear, and not misleading.
- 7.6. Licensed VASPs must not, deliberately or negligently, mislead a client in relation to the real or perceived benefits of any virtual assets.
- 7.7. Licensed VASPs must provide full and proper disclosure of their operations including disclosure of:
 - a) the capacity they are acting in (in relation to a relevant transaction);
 - b) the quantity, value, or arrangements for the payment or provision of commissions or other inducements;
 - c) the schedule of fees, including any changes to those fees, the manner in which fees can be amended, and any associated or indirect costs; and
 - d) where applicable, provisions for custodial or other third-party arrangements.
- 7.8. Licensed VASPs must ensure that their fee and commission structures are transparent, fair, and non-discriminatory.
- 7.9. Licensed VASPs must disclose fees and commissions within their terms of business for the services they provide before any transactions take place. Any

changes to fees, commissions, or terms of service must be brought to the attention of the client in a clear and timely manner.

- 7.10. Any disclosure of conflicts of interest must be in written form and include sufficient detail, taking into account the nature of the client, to enable the client to take an informed decision with respect to the product or service in the context of which the conflict of interest arises.
- 7.11. Every director and senior officer must disclose any conflicts of interest to the governing body on at least an annual basis. Where new conflicts arise, directors and senior officers must declare these and recuse themselves from decisions where a conflict of interest exists.
- 7.12. Disclosure requirements, within this Rule, must be observed at all times as it is an ongoing obligation.

Risk warnings

- 7.13. Licensed VASPs must make appropriate, timely, and prominent disclosures to clients regarding risks associated with the products or services offered, to ensure that clients can make well-informed decisions. Disclosure of risks must be continually assessed and updated to reflect evolving risks.
- 7.14. Licensed VASPs must also disclose all internal safeguards in place to mitigate risks, including the methods of access to virtual assets held, and any insurance arrangements to cover against theft or loss of assets.

Complaints handling

- 7.15. Licensed VASPs must:
 - a) establish and maintain adequate policies and procedures for the handling of client complaints in a fair and consistent manner;
 - b) address client complaints in a timely and fair manner and communicate the outcome of complaints within a reasonable timeframe;
 - c) maintain a log of client complaints and resolution for operational risk purposes, which must be made available to the Authority; and
 - d) report to the Authority any client complaints or set of client complaints that represent a material risk to clients or are indicative of a material failure of the licensed VASP's control environment.

Marketing & promotions

- 7.16. Licensed VASPs must ensure that any marketing communications of their products or services are fair, clear, and not misleading, and are clearly identifiable as marketing or advertising.

- 7.17. Licensed VASPs must ensure that advertising or marketing communications do not, deliberately or negligently, mislead a client in relation to the real or perceived advantages of virtual assets.

Client protection

- 7.18. Licensed VASPs should ensure that their products and services, offered to each client, are suitable having regard to the client's needs, objectives and financial situation, risk tolerance, knowledge, experience and understanding of the risks involved.
- 7.19. Where a licensed VASP decides to cease any virtual asset services, it must notify and provide a plan to the Authority, for its approval. Licensed VASPs must ensure that any outstanding business is properly completed with minimum disruption to clients.

Client agreement

- 7.20. A licensed VASP must have a written agreement in place with all clients, which should include at a minimum the requirements set out in the Act.
- 7.21. Licensed VASPs must provide clients with written confirmation upon execution of a transaction which include all relevant details of the transaction.

Outsourcing

- 7.22. Licensed VASPs must develop and implement a comprehensive outsourcing policy to guide the assessment of whether any activity can be appropriately outsourced. The policy must include periodic review of the third party, contingency plans and exit strategies.
- 7.23. A licensed VASP must ensure that the Authority's supervisory functions and legal obligations are not hindered by the outsourcing of any material function or activity.
- 7.24. Whenever a licensed VASP decides to outsource any of its activities, its governing body must maintain responsibility for every outsourced function. The governing body must ensure that requirements in relation to each outsourced activity are being complied with and that the activities are carried out to the same standard as if these were performed by the licensed VASP.
- 7.25. Licensed VASPs must:
- a) take reasonable steps to avoid additional operational risks arising from any outsourcing arrangements;
 - b) enter into a written agreement with all outsourcing providers which specifies each parties' rights and obligations; and
 - c) have appropriate resources to assess the quality of the service provided by the outsourced service provider.

- 7.26. Licensed VASPs must make available to the Authority, upon request, all information necessary to assess compliance with this Rule in relation to any outsourced activity. Compliance with this Rule must be consistent with the *Rule and Statement of Guidance on Outsourcing*.

Data protection

- 7.27. Licensed VASPs must have systems and procedures in place to safeguard the security, integrity, and confidentiality of information.

Record-keeping

- 7.28. Licensed VASPs must:
- a) keep and maintain orderly records of their business and internal organisation in a manner that promotes accessibility, retention, and appropriate security;
 - b) keep available for review, the relevant data relating to all orders and transactions in virtual assets which are undertaken through their systems and all information obtained through client due diligence measures;
 - c) keep and maintain a record of all interactions with clients including all agreements entered into; and
 - d) have in place a record-keeping system that is held in an auditable format and that allows for information to be made available to the Authority upon request.

8. Prudential

Regulatory capital

- 8.1. Licensed VASPs must, at all times, have in place capital in the form of the higher of:
- a) the minimum capital amount as set out in rule 8.2 in a) to d) below;
 - b) their risk-based capital; or
 - c) the amount equal to six months fixed overheads of the licensed VASP; or
 - d) such amount as determined by the Authority
- 8.2. The amount of required minimum capital will be dependent on the activities or services that a licensed VASP is authorised to provide, as follows:
- a) virtual asset custodians are required to hold a minimum capital amount equal to CI\$125,000;
 - b) virtual asset trading platforms that do not hold custody of or control virtual assets on behalf of clients to facilitate an exchange, but purchase virtual assets from a seller when transactions or bids and offers are matched in order to sell

them to a buyer, are required to hold a minimum capital amount equal to CI\$75,000;

- c) virtual asset trading platforms that hold custody of or control virtual assets on behalf of clients to facilitate an exchange, regardless of whether they purchase virtual assets from a seller when transactions or bids and offers are matched in order to sell them to a buyer, are required to hold a minimum capital amount equal to CI\$100,000; and
 - d) virtual asset trading platforms that are also virtual asset custodians are required to hold a minimum capital amount equal to CI\$175,000.
- 8.3. Risk based capital will be determined having regard to the the size, scope, complexity and nature of the activities and operations of the licensed VASP and the type and level of risks the licensed VASP is exposed to.
- 8.4. The Authority may require a Licensed VASP to hold an additional capital buffer as it deems fit.
- 8.5. Licensed VASPs must review the adequacy of their capital at least on an annual basis, or when there has been a material change to the business.
- 8.6. Licensed VASPs must notify the Authority of any decision to increase regulatory capital held, and must seek approval from the Authority for any reduction in regulatory capital.

Recovery plan

- 8.7. Licensed VASPs must assess and document scenarios that could lead to a breach of the capital requirement and address these scenarios in a recovery plan which should aim to preserve critical functions and detail steps to capital recovery.
- 8.8. Licensed VASPs must have defined financial and non-financial triggers in place that will alert to the need for the execution of the recovery plan.

Stress testing

- 8.9. When calculating the amount of capital to be held, licensed VASPs must undertake stress testing of scenarios and conditions as well as sensitivity analysis and document the triggers needed to identify such situations.

Insurance

- 8.10. Where appropriate, licensed VASPs must maintain insurance protections to the satisfaction of the Authority, including the following:
- a) professional liability of senior officers;
 - b) loss of client assets held in custody;
 - c) business interruption; and

- d) cyber security.

9. Risk Management

- 9.1. Licensed VASPs must employ forward-looking risk management practices and always consider risks to clients and the reputation of the Cayman Islands, in addition to risks to their own business.
- 9.2. In conducting business activities, licensed VASPs must act with due skill, care, and diligence, in the best interests of their clients and the integrity of the market.

Internal controls

- 9.3. A licensed VASP must establish, implement, and maintain sound internal controls appropriate to the size, complexity, and nature of its activities.
- 9.4. Internal controls, strategies, policies, and procedures must be approved by the governing body of the licensed VASP.
- 9.5. A licensed VASP must take the necessary steps to monitor its internal controls and provide internal control reports to its governing body.

10. IT and Cybersecurity

- 10.1. The IT and cyber security strategies of a licensed VASP must be reviewed and approved by the entity's governing body annually.
- 10.2. Licensed VASPs must, on an annual basis, review the cybersecurity and IT risks they face and assess their cybersecurity framework to ensure it continues to be appropriate to manage adverse impacts of the cyber risks and IT risks.
- 10.3. Licensed VASPs must have in place adequate and documented policies around:
 - a) cybersecurity;
 - b) incident response and recovery; and
 - c) backups and business continuity.
- 10.4. Licensed VASPs must ensure that roles and responsibilities are well defined within the organisation individuals responsible for general IT controls, information security/cyber security and private key management must be identified and made known to the rest of the organisation.

11. Virtual Asset Custody Service

- 11.1. Licensed VASPs that provide virtual asset custody services must:
 - a) take all reasonable steps to protect client assets and ensure that client assets are clearly identified and segregated from proprietary assets.

- b) establish a custody policy with internal rules and procedures to ensure the safekeeping or the control of such virtual assets, or the means of access to the virtual assets; and
- c) ensure that virtual assets and fiat funds belonging to clients are protected from third party creditors.

Segregation of virtual assets

- 11.2. Licensed VASPs that provide virtual asset custody services must maintain a register of positions in the name of each client, reflecting the value and client ownership of the virtual assets. Licensed VASPs must, on this register, maintain an ongoing record of any movement in client positions, and evidence of corresponding transactions.
- 11.3. Licensed VASPs holding virtual assets on behalf of clients must ensure that client funds are kept in clearly identifiable segregated wallets from that of the licensed VASP.
- 11.4. Licensed VASPs outsourcing custody of client virtual assets to third parties must ensure that the third parties are, at all times, in compliance with the relevant requirements under the Act, this Rule and other applicable regulatory measures.

Segregation of fiat funds

- 11.5. Licensed VASPs holding fiat currencies on behalf of clients must ensure that client funds are kept safe and are held with a licensed bank or other similar institution acceptable to the Authority, in clearly identifiable segregated accounts.

Reconciliation

- 11.6. Licensed VASPs that provide virtual asset custody services must:
 - a) take reasonable steps to ensure that client account balances are accurate;
 - b) perform frequent reconciliation of client virtual assets and fiat balances;
 - c) reconcile internally calculated balances to the expected balance on the relevant distributed ledger, and investigate any discrepancies.

Management of private keys

- 11.7. Licensed VASPs that provide virtual asset custody services must:
 - a) implement industry best practices for the generation, storage and usage of private keys;
 - b) implement backup procedures for all private keys which are in line with industry best practices;

- c) implement a Key Compromise Protocol which is tested and reviewed at least annually;
- d) have controls in place to meet liquidity and other demands; and
- e) arrange for security audits to be performed on a regular basis.

Naming and schema

- 11.8. Licensed VASPs that provide virtual asset custody services must ensure that naming conventions and schema for information used to identify and protect client assets allow for the licensed VASP, the Authority, or any mandated third-party, to manage the licensed VASP and client assets, as required.

12. Virtual Asset Trading Platforms

Market integrity

- 12.1. Virtual asset trading platforms must implement systems and procedures to monitor and detect market abuse and to promote the best interests of clients and the integrity of the market. Any suspicions indicating that market abuse or other unfair trading practices are being, have been, or are likely to be committed, must be reported to the Authority immediately.
- 12.2. Virtual asset trading platforms must undertake regular assessments to identify the inherent risks in relation to insider dealing and market manipulation and determine any measures necessary to mitigate such risks.
- 12.3. Virtual asset trading platforms must have systems in place to allow the freezing of client accounts and the suspension of trading of virtual assets when financial crime or market abuse are suspected, or when the virtual asset no longer complies with the trading platform's rules.
- 12.4. For high-risk products or services offered, virtual asset trading platforms must take appropriate steps to ensure that clients are aware of, and have acknowledged, the risks associated with these products or services.
- 12.5. Virtual asset trading platforms must ensure that they have documented and recorded the client's understanding of the products or services and the client's acknowledgement of the associated risks.
- 12.6. Virtual asset trading platforms must advise clients of the option to seek third party custodian services to assist in the protection of client assets and record the client's acknowledgement of this notification.
- 12.7. Virtual asset trading platforms must establish appropriate and effective systems and procedures to ensure their platforms are robust and can adapt to market stress. Platforms should also be able to reject orders that exceed pre-determined volumes or price thresholds, or transactions involving a particular sender/receiver.

Clearing and settlement

12.8. Virtual asset trading platforms must establish procedures for the efficient clearing and settlement of virtual asset and fiat currency transactions.

Provision of financing to purchase virtual assets (leveraged trading)

12.9. Virtual asset trading platforms that provide financing to clients must disclose the terms of the agreement as well as the risks involved.

12.10. Virtual asset trading platforms that provide financing to clients must put in place:

- a) measures to ensure client losses are limited; and
- b) internal or commercially obtained insurance, where appropriate, to cover risks associated with losses or market movements.

Pricing

12.11. Virtual asset trading platforms must make their pricing policies, including information on price discovery mechanisms, easily accessible, publicly available and prominently displayed on their website.

12.12. Virtual asset trading platforms must implement pricing policies and procedures that prevent unfair trading activities and market abuse.

Listing rules

12.13. Virtual asset trading platforms must establish a set of rules to determine whether or not to admit virtual assets to be listed on their platforms. The rules must establish the requirements, due diligence, and approval process to admit virtual assets to the platform.

12.14. Virtual asset trading platforms must not admit to the platform virtual assets with inbuilt anonymisation features unless they are able to easily identify the holders and transaction history of such assets.

12.15. When determining whether or not to accept virtual assets to be listed on their platform, a virtual asset trading platform must consider the quality of the virtual asset, taking into account the experience, track record, and reputation of the issuer and its development team.

12.16. Virtual asset trading platforms must develop policies and procedures setting out platform participants' ongoing obligations and defining the following:

- a) criteria to participate in trading activities;
- b) rules and requirements for fair and orderly trading; and
- c) conditions for suspension.



13. Reporting

Regulatory reporting

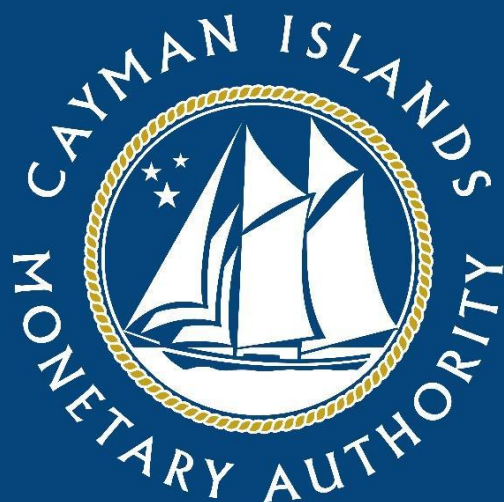
- 13.1. The Authority may, where relevant, prescribe reporting requirements to which licensed VASPs must adhere to.
- 13.2. Licensed VASPs must establish a framework setting out their reporting obligations to the relevant authorities in accordance with the Act, including the process by which any new reporting obligations are flagged and acted upon.

14. Enforcement

- 14.1. Whenever there has been a breach of this Rule, the Authority's policies and procedures as contained in its Enforcement Manual will apply, in addition to any other powers provided in the Act and the MAA, as amended.

15. Effective Date

- 15.1 This Rule will come into effect within six months of the date that it is published in the Gazette.



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