



# **PRIVATE SECTOR CONSULTATION**

**Rule and Statement of Guidance for the provision of virtual asset services-  
Virtual Asset Custodians and Virtual Asset Trading Platforms**

**February 2022**

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**A. Introduction**

1. Section 34(1)(a) of the Monetary Authority Act (2020 Revision) (“MAA”) states that–

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

*(a) 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”.*

2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAA as follows:

*“When this Law requires private sector consultation in relation to a proposed measure–*

*(a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*

- i. an explanation of the purpose of the proposed measure;*
- ii. an explanation of the Authority’s reasons for believing that the proposed measure is compatible with the Authority’s functions and duties under section 6;*
- iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
- iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
- v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3)); and*

*(b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations.”*

3. The Cayman Islands Monetary Authority (“the Authority” or “CIMA”) seeks consultation and comment from the private sector associations concerning the new proposed Rule and Statement of Guidance for the provision of virtual asset services- Virtual Asset Custodians and Virtual Asset Trading Platforms (see **Appendices A and B** respectively).

**B. Background/ Scope of Application**

4. In May 2020, the Virtual Asset (Service Providers) Act (“VASP Act”) was enacted and certain provisions were commenced in October 2020.

5. The VASP Act, among other things, empowers the Authority to licence and supervise VA custodians and VA trading platforms which includes, inter alia, the imposition of prudential requirements by the Authority. In that regard, a Rule and Statement of Guidance ("SOG") have been developed which, following consultation, will support the VASP licensing regime by, among other things, adding legitimacy and certainty to the virtual assets sector, promote market integrity and consumer/investor protection while supporting innovation.

**C. Purpose of Proposed Measure and Consistency with Authority's Functions**

6. Pursuant to section 6(1)(b) of the MAA, one of the principal functions of the Authority is:  
*"b) regulatory functions, namely -*
  - (i) to regulate and supervise financial services business carried on in or from within the Islands in accordance with this Law and the regulatory laws;*
  - (ii) to monitor compliance with the money laundering regulations; and*
  - (iii) to perform any other regulatory or supervisory duties that may be imposed on the Authority by any other law;"*
7. Section 6(3) of the MAA provides that in performing its regulatory functions, the Authority shall, *inter alia*:
  - i. "endeavour to promote and enhance market confidence and the reputation of the Islands as a financial centre;*
  - ii. recognise the international character of financial services and markets and the necessity of maintaining the competitive position of the Islands, vis a vis both consumers and suppliers of financial services, while conforming to internationally applied standards insofar as they are relevant and appropriate to the circumstances of the Islands;*
  - iii. recognise the principle that a burden or restriction which is imposed on a person or activity should be proportionate to the benefits, considered in general terms; and*
  - iv. recognise the need for transparency and fairness on the part of the Authority".*
8. The VASP Act, as a regulatory law, sets out at section 9 the general regulatory requirements for VASPs including the submission of annual accounts, fitness and propriety of senior officers, trustees and beneficial owners, the protection of client data and virtual assets and compliance with all anti-money laundering requirements. Sections 10 and 11 refer to specific requirements that may be imposed by the Authority on a custodian or trading platform (respectively); as it relates to prudential standards including net worth and reporting requirements and obligations of disclosure to clients.
9. The proposed Rule supports the regulatory requirements in the VASP Act by setting out obligations for both custodians and trading platforms in areas such as governance, conduct of business, prudential requirements, risk management as well as IT and cybersecurity. The Rule also separately ascribes obligations to trading platforms and persons providing virtual asset custody services as appropriate to the nature of their business.

10. The SOG expands on the Rule by providing insight as to how VASPs should comply with the Rule, including the systems, policies and procedures that need to be in place; along with factors that should be considered in implementing same.
11. The proposed regulatory measures therefore align with the regulatory function of the Authority at Sections 6(1) and 6(3) of the MAA, and the duties of the Authority as set out in the VASP Act.

#### **D. International Standards**

12. Due to the nascent nature of the VA industry, there are currently no harmonised international standards for the prudential regulation and supervision of virtual assets service providers. It is noted that the Financial Actions Task Force (FATF) has issued recommendations that address virtual asset activities and service providers, from an AML/CFT perspective, and these recommendations have already been adopted in the Authority's Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands.

#### **E. Jurisdictional Comparisons**

13. A review of the legislative and regulatory approaches for VASPs, with a focus on virtual asset custodians and trading platforms, in various jurisdictions was conducted to ascertain suitable regulatory measures for the Cayman Islands.
14. The jurisdictions reviewed were the Bahamas, Bermuda, Estonia, Gibraltar, Hong Kong, Japan, Liechtenstein, Malta as well as the European Union (namely the proposed Markets in Crypto-assets Regulation). More particularly, requirements in relation to corporate governance, conduct of business, operational matters, prudential, risk management, reporting, safeguarding of assets, and IT and cybersecurity imposed on VASPs were reviewed.
15. It is noted at the outset that the approach to virtual assets and related activities was observed to vary significantly among the various jurisdictions. In some cases, jurisdictions have amended existing financial services regimes, such as those applicable to banking and investment activities, to bring virtual assets and related activities within their remit. Several others have introduced entirely new regimes to deal specifically with virtual assets, while some have asserted that existing regulatory frameworks already apply to virtual assets.

##### **Bahamas**

16. The Bahamas Digital Assets and Registered Exchanges Act (DARE) was enacted in November 2020, and introduced a registration framework for entities providing any of the following activities:
  - a. issuance of virtual assets;
  - b. operating a virtual asset exchange;
  - c. providing services related to a virtual asset exchange;
  - d. facilitating the exchange between virtual assets and fiat currencies or other virtual assets, or transferring virtual assets;
  - e. operating as a payment service provider business utilizing virtual assets;
  - f. participating in and providing financial services related to an issuer's offer or sale of virtual assets;
  - g. any other activity that may be prescribed by regulations.

- 17.** The provision of custodial services of virtual assets is dealt with under separate legislation, that is, the Financial and Corporate Service Providers Act 2020 (FCSP).

*Bermuda*

- 18.** Bermuda has two main pieces of legislation that specifically deal with virtual assets; the Digital Asset Businesses Act 2018, and the Digital Asset Issuance Act 2020. The jurisdiction's framework for virtual asset service providers is a licensing regime offering different licensing options. Entities providing any of the following services must be licensed in Bermuda:
- a. issuing, selling, or redeeming virtual assets;
  - b. operating a payment service provider utilising virtual assets;
  - c. operating as a virtual asset exchange;
  - d. undertaking virtual asset trust services;
  - e. providing custodial wallet services;
  - f. operating as a virtual asset derivative exchange provider;
  - g. virtual asset benchmark administrators;
  - h. operating as a virtual asset services vendor.

*Estonia*

- 19.** Estonia's regime for virtual assets is an AML/CFT licensing regime requiring firms to seek authorization from the Financial Intelligence Unit to provide services with virtual assets. The framework applies to virtual asset custodians and virtual asset exchanges facilitating exchanges between virtual assets and fiat, and other virtual assets.

*Gibraltar*

- 20.** Gibraltar adopted legislation in 2018 (Financial Services (Distributed Ledger Technology) Regulations 2017) to introduce a licensing framework based on regulatory principles for entities that use DLT to transmit or store value belonging to others. The regime goes beyond an AML/CFT framework, requiring that conduct of business and prudential requirements are adhered to. The Gibraltar Financial Services Commission has published comprehensive guidance notes to assist licensees in their implementation of policies and procedures to ensure that they meet regulatory principles. Namely:
- a. DLT Providers Guidance Note – Honesty and Integrity
  - b. DLT Providers Guidance Note – Corporate Governance
  - c. DLT Providers Guidance Note – Financial and non-financial resources
  - d. DLT Providers Guidance Note – Risk Management
  - e. DLT Providers Guidance Note – Protection of Client Assets and Money
  - f. DLT Providers Guidance Note – Customer Care
  - g. GFSC Guidance Note – Outsourcing
  - h. DLT Providers Guidance Note – Financial Crime
  - i. DLT Providers Guidance Note – Systems and Security Access

*Hong Kong*

- 21.** To date, in Hong Kong, only virtual assets with issuance terms resembling those of securities or the trading of securities fall under the scope of regulation. As such, only virtual asset trading platforms that facilitate trading in virtual assets amounting to securities or futures contracts fall under the purview of the Securities and Futures Commission (SFC). Virtual asset trading platforms dealing with non-security virtual assets do not currently require a licence to operate.

- 22.** However, it is noted that the Hong Kong Government is in the process of drafting a Bill, for amendments to their AML/CFT legislation; which includes bringing non-security virtual asset exchange service providers within the AML/CFT regime. The effect of these amendments, when implemented, would require entities providing virtual assets exchange services, that do not qualify as securities, to be required to apply for a licence to the SFC and comply with AML/CFT requirements.

Japan

- 23.** Crypto asset businesses in Japan fall under the scope of either the Financial Instruments and Exchange Act (FIEA), or the Payment Services Act (PSA), depending on the type activity conducted. Japan has not introduced legislation to deal specifically with VASPs, instead it amended existing legislation to extend its scope to cover virtual asset activities. The current regime in Japan applies to the following entities:
- a. Virtual asset exchange service providers.
  - b. VASPs conducting derivative and security token offerings.
  - c. Virtual asset custodians.

Liechtenstein

- 24.** Liechtenstein adopted its Token and Trustworthy Technology Service Provider Act (TTT Act) in January 2020. Entities wishing to register under the TTT Act must comply with conduct of business and prudential requirements in addition to AML/CFT obligations.

Malta

- 25.** Malta introduced a regulatory framework for virtual asset service providers in 2018 with the adoption of its Virtual Financial Assets Act which covers, among other things:
- a. Virtual financial assets issuances.
  - b. The operation of virtual financial asset exchanges.
  - c. Custodian and Nominee services for virtual financial assets or private cryptographic keys.
  - d. Management of assets that consist of one or more virtual financial asset.

European Union (EU)- Proposed Markets in Crypto-assets Regulation (MiCA)

- 26.** The EU has proposed a Regulation to bring crypto-assets activities, within the EU, within the scope of regulation. The proposed Regulation is intended to apply consistently across all EU jurisdictions, bringing all crypto-assets activities, that are not already covered by other regulatory frameworks, under the scope of the Regulation.
- 27.** For the purpose of this jurisdictional comparison, the current available draft of the Regulation was considered. MiCA introduces a framework for issuers of crypto-assets, issuers of asset-referenced tokens, issuers of e-money tokens, and crypto-asset service providers that provide any of the following services:
- a. the custody and administration of crypto-assets on behalf of third parties;
  - b. the operation of a trading platform for crypto-assets;
  - c. the exchange of crypto-assets for fiat currency that is legal tender;
  - d. the exchange of crypto-assets for other crypto-assets;
  - e. the execution of orders for crypto-assets on behalf of third parties;
  - f. placing of crypto-assets;

- g. the reception and transmission of orders for crypto-assets on behalf of third parties;
- h. providing advice on crypto-assets.

28. Having assessed the relevant approaches in the above noted jurisdictions, key requirements imposed by each jurisdiction for virtual asset service providers, are summarised in the attached **Appendix C**.

**F. Cost-Benefit Assessment of Implementing the Proposed Rule and SOG**

29. **Table 1** shows the estimated costs and benefits of the proposed Rule and Statement of Guidance.

**Table 1 – Estimated Costs and Benefits of Regulatory Measures**

	Costs	Benefits
<b>CIMA</b>	<ul style="list-style-type: none"> <li>1. Processing Rule and SOG and conducting consultation.</li> <li>2. Staff training</li> <li>3. Conducting outreach to VASP sector and responding to queries from VASP sector.</li> <li>4. Gazettal and publication of measures.</li> <li>5. Cost of implementing and monitoring compliance with the Rule and SOG.</li> </ul>	<ul style="list-style-type: none"> <li>1. The Rule and supporting SOG will provide clarity and certainty on the expectations of Authority in its supervision of VASP custodians and trading platforms. This is critical, particularly for an industry that has only recently been included within the Authority’s regulatory remit.</li> <li>2. The Rule and SOG will provide a much-needed supporting framework for the licensing/supervision regime for VASP custodians and trading platforms.</li> <li>3. Enhances the reputation of the Authority, as a regulator, having put in place appropriate measures to supervise the newly regulated VASP sector.</li> </ul>

<b><i>Cayman Islands</i></b>	<ol style="list-style-type: none"> <li>1. It is not anticipated that there will be any costs to the jurisdiction as a whole with the implementation of the measure.</li> <li>2. VASPs may choose not to operate in the Cayman Islands due to the comprehensiveness of the regulatory requirements.</li> </ol>	<ol style="list-style-type: none"> <li>1. Sets precedent for other jurisdictions as there are limited jurisdictions that have issued Rules and Guidance for VASPs.</li> <li>2. Enhances the reputation of the jurisdiction, since there will be appropriate measures in place to guide the VASP sector and consequently will have a significant and positive impact on confidence in the Cayman Islands as a strong well-regulated financial centre.</li> </ol>
<b><i>VASPs</i></b>	<ol style="list-style-type: none"> <li>1. Compliance costs relating to implementation of key requirements as described in the Rule and Statement of Guidance, including ensuring systems and controls meet standards required by CIMA.</li> <li>2. Implementation of forms, policies and procedures, systems and controls.</li> <li>3. Costs for insurance coverage whether commercial or self-insurance.</li> </ol>	<ol style="list-style-type: none"> <li>1. Provides a clear framework within which to operate, in an otherwise previously unregulated space.</li> <li>2. Gain reputation for meeting regulatory standards.</li> <li>3. May result in reduced regulatory burdens in other jurisdictions of operation if Cayman Islands regime is deemed to be equivalent (i.e. substituted compliance).</li> </ol>

**30.** Consequent to the above, it is determined that the benefits outweigh the costs and the implementation of the Rule and Statement of Guidance for the provision of virtual asset services - Virtual Asset Custodians and Virtual Asset Trading Platforms should be pursued by the Authority.

**G. Consultation Feedback and Comments**

**31.** Before proceeding with the proposed measures, the Authority shall have regard to any representations made by the private sector associations only. Feedback submitted by individuals, entities, or other bodies, unless acting on behalf of private sector associations, will not be accepted by the Authority. Representations from private sector associations must be submitted as a consolidated document, and a listing of the entities which provided feedback should be included. Private sector associations should ensure that conflicting positions are resolved prior to submission to the Authority. Where positions conflict within or across associations, the Authority will consider all available information in taking a decision, which will be at its sole discretion.



- 32.** To ensure that all responses are given due consideration, it is important that private sector associations make clear reference to the sections of the measure being commented on, and that responses are unambiguous, clearly articulated and based on fact. The consultation process is not designed to address complaints or grievances. Feedback of this nature should be submitted through the established complaints process.
- 33.** In cases where the feedback proposes to change a policy position of the Authority or substantially amend any requirement of the draft measures, information to support the position of the association must be provided. The table below provides an example of the Authority’s expectation with regard to feedback for the proposed measures.

Reference	Example of a Helpful Comment	Examples of Comments needing more Support
Rule 4.2 <sup>1</sup>	<p>In Rule 4.2 the current text omits the fair value measurement of liabilities. Also, as defined it is not asymmetrical with the Market Price definition and thus scenarios exist that fall into neither category.</p> <p><b>Suggested wording:</b>  <i>Hard-to-Value Securities means an asset or liability for which there is no Market Price which is required to be measured at fair value pursuant to 5.2</i></p>	<ul style="list-style-type: none"> <li>× This is not what is done in other jurisdictions.</li> <li>× I don’t think we should do this.</li> <li>× CIMA is not considering the position of the experts.</li> </ul>

- 34.** All feedback submitted by private sector associations will be given due consideration. Nevertheless, the decision to adopt any feedback provided into a proposed measure will be at the sole discretion of the Authority.

**H. Notice of Representations**

- 35.** The Authority seeks consultation through written comments and representations from the private sector associations concerning the:

*Rule and Statement of Guidance for the provision of virtual asset services - Virtual Asset Custodians and Virtual Asset Trading Platforms.*

- 36.** The Authority must receive representations by 1700hrs on **March 07, 2022**. Representations received after this deadline may not be considered and will not form part of the collated written response provided to private sector associations.

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<sup>1</sup> This example is not reflective of the content of the proposed measure.

- 37.** Comments and representations must be addressed to:

The Managing Director  
Cayman Islands Monetary Authority  
P.O. Box 10052  
SIX, Cricket Square  
Grand Cayman KY1-1001  
Cayman Islands  
Tel: 345-949-7089  
Fax: 345-946-5611  
Email: [consultation@cima.ky](mailto:consultation@cima.ky)  
and copied to [KavitaMaharajAlexander@cima.ky](mailto:KavitaMaharajAlexander@cima.ky).

- 38.** The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.



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