



# **PRIVATE SECTOR CONSULTATION**

**Amendments to the Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands of June 5, 2020 – *Virtual Asset Service Providers*.**

**November 2020**

## Private Sector Consultation

### **Amendments to the Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands of June 5, 2020 – *Virtual Asset Service Providers*.**

#### **A. Introduction**

1. Section 34(1)(a) of the Monetary Authority Law (2020 Revision) ("MAL") 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 MAL 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 revisions to the sector specific Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands ("GNs") (Appendix 1).
4. The GNs apply to all virtual asset service providers and/or persons engaged in virtual asset services, as defined in the Virtual Asset (Service Providers) Law ("the VASP Law"<sup>1</sup>).

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<sup>1</sup> Law No. 14 of 2020

## **B. Background/ History**

5. VASP Law was brought into force in phases effective October 31, 2020.
6. In preparation of the commencement of the VASP Law and Regulations, the Authority performed a review of the GNs, and more particularly PART IX of the Sector Specific Guidance for Virtual Asset Service Providers (VASPs), to determine how same may be revised to address Anti-Money Laundering (AML)/Countering Financing of Terrorism (CFT) obligations in respect of virtual asset exchange providers, virtual asset custodians and virtual asset issuers. In that regard, the Authority is proposing that some aspects of the GNs be revised.

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

7. Pursuant to section 6(1)(b) of the MAL, 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;"*
8. Section 6(3) of the MAL 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.
9. The VASP Law provides a framework for the conduct of virtual asset business in the Islands, the registration and licensing of persons providing virtual asset services by the Authority and for incidental and connected purposes.
10. The current GNs provide sector specific guidance for VASPs, consistent with the requirement of Schedule 6 of the Proceeds of Crime Law (PoCL)<sup>2</sup> together with the Anti-Money Laundering Regulations (AMLRs), and in line with Financial Action Task Force (FATF) recommendations. However, the GNs do not consider the provisions of the VASP Law, since same was still being developed at the relevant time of issuance. In that regard, the Authority is proposing amendments to the GNs to expand on the AML/CFT obligations in respect of VASPs and in particular persons conducting virtual asset custodial services or operating virtual asset exchange platforms as well as those persons issuing newly created virtual assets. This will enhance the regulatory

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<sup>2</sup> PoCL lists activities falling within the definition of 'relevant financial business' and includes 'providing virtual asset services'.

function of the Authority in line with Sections 6(1) and 6(3) of the MAL, as stated above.

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

- 11.** The FATF recommendations are the internationally endorsed global standards against money laundering (ML), proliferation financing (PF) and terrorist financing (TF).
- i. FATF Recommendation 15 requires that countries and financial institutions identify and assess the ML/TF/PF risks that may arise in relation to the development of new products and new business practices, including new delivery mechanisms, and the use of new or developing technologies for both new and pre-existing products. In addition, financial institutions should be required to undertake risk assessments prior to the launch or use of such products, practices and technologies and take the appropriate measures to manage and mitigate the risks.
  - ii. In October 2018, FATF updated its Recommendations to explicitly clarify that they apply to financial activities involving virtual assets.
  - iii. In June 2019, FATF added the Interpretive Note to Recommendation 15 ("IN-R.15") which sets out the application of the FATF Recommendations to virtual asset activities and service providers. The FATF IN R.15 was also updated to assist competent authorities and private sector entities in understanding AML/CFT components and obligations as they related to virtual assets (VAs) and VASPs. It also covers the application of other FATF Recommendations in the context of VAs and VASPs.
  - iv. In September 2020, FATF issued a Report on Virtual Assets Red Flag Indicators of Money Laundering and Terrorist Financing.

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

- 12.** In reviewing the current sector specific guidance for VASPs, the jurisdictions of Malta, Bermuda, Gibraltar, Malaysia and the UK were considered for comparison. Only the UK specifically addresses crypto assets, crypto exchange providers and custodian wallet providers.
- 13.** Although Malta has a legal framework in place for the authorisation and supervision of Virtual Financial Assets, no sector specific guidance appears to have been issued in respect of the AML/CFT obligations. Malta relies on its legislation to implement AML/CFT requirements.
- 14.** Both Bermuda and Gibraltar have issued guidance notes for digital asset businesses and Distributed Ledger Technology (DLT) providers<sup>3</sup>, respectively. The guidance on AML/CFT for both jurisdictions focus on general guidance for all providers (including guidance in respect of risk-based approaches, client due diligence (CDD), ongoing

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<sup>3</sup> In the case of Gibraltar, DLT providers include a wide range of persons conducting activities not subject to regulation, under another framework, and that use DLT for the transmission or storage of value belonging to others. These can include custodian wallet providers, VC exchanges, trading platforms, payment service providers, remittance service providers etc.

monitoring, suspicious activities reporting, etc), but does not identify or differentiate between custodians or trading platforms or other VA service providers.

- 15.**Malaysia's standards/guidance document focuses solely on exchanges and addresses requirements such as risk-based approaches, new digital currencies, products and business practices, CDD, record keeping, suspicious activities reporting, etc.
- 16.**The guidance framework, for the four jurisdictions mentioned above, do not closely align with the GNs, as they do not specifically address custodians and exchange providers.
- 17.**The UK's Guidance<sup>4</sup> may be differentiated from the other jurisdictions as it specifically addresses crypto assets, crypto exchange providers and custodian wallet providers. The Guidance identifies ML/TF/PF risks in the sector, the factors that give rise to these risks as well as who is the customer for a custodian and an exchange provider for the purpose of risk assessment.
- 18.**The UK Guidance also addresses the conduct of risk assessment, based on various types of risk, and raises new suggestions for the monitoring of risks (such as blockchain analysis), the applicability of record keeping to custodians and exchange providers; in addition to the broad guidance relevant to the use of virtual assets and the connection to ML/TF/PF risks.

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<sup>4</sup> In July 2020, the United Kingdom Joint Money Laundering Steering Group (UK JMLSG), a private sector body that is made up of the leading UK Trade Associations in the financial services industry and provides guidance on compliance with AML/CFT obligations) published Guidance in respect of inter alia, crypto asset exchange providers and custodian wallet providers. The Guidance received Her Majesty's Treasury (HM Treasury) ministerial approval in August 2020. The UK is one of the few jurisdictions to have published sector specific guidance in respect of crypto asset exchange providers and custodians.

**F. Cost-Benefit Assessment of Implementing the Proposed Amendments to the GNs**

**19.** The relevant costs and benefits associated with the implementation of the proposed amendments to the GNs are presented in Table I.

**Table I: Costs and Benefits of Implementing the Proposed Amendments to the GNs**

	<b>Costs</b>	<b>Benefits</b>
<b><i>CIMA</i></b>	<ol style="list-style-type: none"> <li>1. Processing amendments and conducting consultations.</li> <li>2. Staff training.</li> <li>3. Conducting outreach to VASPs.</li> <li>4. Responding to VASP queries.</li> <li>5. Costs of monitoring compliance with the GNs.</li> </ol>	<ol style="list-style-type: none"> <li>1. More clarity ensures greater compliance by VASPs in respect of their AML/CFT obligations, particularly during onsite inspections, resulting in more consistency between regulated entities and more streamlined inspections and reports.</li> <li>2. Savings of time when compared to responding to queries from individual institutions about their obligations.</li> </ol>
<b><i>Cayman Islands</i></b>	<ol style="list-style-type: none"> <li>1. Potential for VASPs currently in the Islands to exit the jurisdiction instead of complying with the amended GNs.</li> <li>2. Gazettal of the amendments upon approval.</li> </ol>	<ol style="list-style-type: none"> <li>1. Enhances the reputation of the jurisdiction, which may lead to more business being done in the Islands.</li> <li>2. Facilitates the investigation and prosecution of offences.</li> <li>3. Enhances compliance of jurisdiction with FATF standards (particularly as it relates to Immediate Outcome (IO) 4 ("IO 4"), thereby reducing likelihood of appearing on blacklists and related consequences of blacklisting (including higher compliance costs and exclusion from certain countries and markets)</li> <li>4. Sets precedent for other jurisdictions to follow.</li> </ol>
<b><i>Regulated Entities</i></b>	<ol style="list-style-type: none"> <li>1. Staff training on the amended AML/CFT requirements for virtual assets.</li> <li>2. Implementation of new forms, policies and procedures, including CDD forms.</li> <li>3. Costs to implement monitoring tools, for example, the use of blockchain analysis.</li> </ol>	<ol style="list-style-type: none"> <li>1. Reduces risk of regulated entity being used to facilitate financial crime, which could jeopardize the VASPs reputation and potentially its ability to carry on business.</li> <li>2. Improved risk management and information on customers could prevent institution from being used to commit financial crime.</li> <li>3. Gain reputation for meeting regulatory standards as it pertains to AML/CFT obligations.</li> </ol>

## **G. Consultation Feedback and Comments**

- 20.** Before proceeding with the proposed measure, 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.
- 21.** 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.
- 22.** In cases where the feedback proposes to change a policy position of the Authority or substantially amend any requirement of the draft measure, 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 measure.

Reference	Example of a Helpful Comment	Examples of Comments needing more Support
Rule 4.2 <sup>5</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><u>Suggested wording:</u></b> <i>Hard-to-Value Securities means an asset <u>or liability</u> for which <u>there is no Market Price which is required to be measured at fair value pursuant to 5.2</u></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>

- 23.** 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.

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<sup>5</sup> This example is not reflective of the content of the proposed measure.

## **H. Notice of Representations**

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

- Amendment to Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands, Part IX, Sector Specific Guidance – Virtual Asset Service Providers.

**25.**The Authority must receive consolidated representations by 1700hrs on **16 December 2020**.

**26.**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.com](mailto:Consultation@cima.com)

[With copy to: aaronunterman@cima.ky](mailto:aaronunterman@cima.ky)

**27.**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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