



# **PRIVATE SECTOR CONSULTATION**

**Statement of Principles for the Conduct of Virtual Asset Services**

**November 2020**

**Private Sector Consultation**  
**Statement of Principles for the Conduct of Virtual Asset Services (“the SoP”)**

**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 the new proposed Statement of Principles for the Conduct of Virtual Asset Services (see Appendix A).

**4.** The new Statement of Principles applies to all virtual asset service providers and/or persons engaged in virtual asset services, as defined in the Virtual Asset (Service Providers) Law<sup>1</sup> (“the VASP Law”).

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

## **B. Background/ Scope of Application**

5. VASP Law was brought into force in phases effective October 31, 2020.
6. In consideration of the phased commencement of the VASP Law and Regulations, the Authority proposes to implement, by way of the SoP, a broad framework and guidance for the conduct of Virtual Asset (VA) activities by Virtual Asset Service Providers (VASPs) in the Cayman Islands. The SoP seeks to establish general standards by which all VASPs should conduct their VA business, and will be used as a measure against which the Authority will assess compliance for Anti-Money Laundering (AML) and prudential purposes.
7. The measure is not intended to replace the comprehensive regulatory measures that will be prepared and implemented in support of the VASP Law, when commenced in full. The use of this measure would, amongst other things, ensure clear guidance on the manner by which VASPs ought to act in providing VA services, would support the Authority's role of assessing compliance (for both AML and prudential purposes) and would satisfy Financial Action Task Force (FATF) recommendations in relation to VASPs.

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

8. 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;"*
9. 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.
10. Given that the VASP Law partially commenced on October 31, 2020, and in the absence of relevant rules, guidance, regulatory policies and procedures to support the implementation of same, the SoP provides guidance to VASPs on how they ought to conduct their VA business from an Anti-Money Laundering (AML) and prudential perspective. In that regard, the contents of the proposed SoP are in alignment with the provisions of the VASP Law and take into account general international standards that apply to most regulated entities, as well as tailored standards based on the contents of the VASP Law and the nature of VASPs. The regulatory function of the

Authority will be enhanced 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 the anti-money laundering (AML)/Countering Financing of Terrorism (CFT) components and obligations as they related to VA 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.**The Authority notes that there are not many jurisdictions that have issued a statement of principles for the conduct of virtual asset services, as this is a versatile and dynamic area. In that regard, comparisons available were limited to two (2) jurisdictions, Gibraltar and Malta. Gibraltar conducts the regulation and supervision of distributed ledger transaction providers via the application of nine regulatory principles. Malta has a Virtual Financial Assets Act which includes principles that must be adhered to by issuers but has not issued a separate statement of principles.
- 13.**The approach of neither Gibraltar nor Malta, on its own, appears to be suitably comprehensive in terms of applicability to the Cayman Islands, having regard to the contents of the VASP Law. Therefore, aspects of each jurisdiction were considered and utilized in proposing a suitable SoP for the conduct of VA services. Table I presents a summary of the jurisdictional comparisons.

**Table I: Summary of Jurisdictional Comparison**

<b>Principles</b>	<b>Gibraltar</b>	<b>Malta</b>	<b>Cayman Islands</b>
Honesty and Integrity	Yes	Yes	Yes
Fair treatment of customers	Yes	No	Yes
The protection of customer data	Yes	No	Yes
Protection and Segregation of client assets	Yes	Yes	Yes
Maintenance of Security Systems	Yes	Yes	Yes
Due skill, care and diligence	No	Yes	Yes
Prevention, detection and disclosure of financial crimes	Yes	Yes	Yes
Avoidance of conflict of interest and unfair dealings	No	Yes	Yes
Adequate Resources	Yes	No	Yes
Full disclosure	Yes	No	Yes
Corporate Governance and Resilience	Yes	No	Yes
Compliance with Regulatory Laws	No	No	Yes

**F. Cost-Benefit Assessment of Implementing the Proposed SoP**

**14.** The relevant costs and benefits associated with the implementation of the proposed SoP are presented in Table II.

**Table II: Costs and Benefits of Issuing the SoP for persons conducting virtual asset services**

	<b>Costs</b>	<b>Benefits</b>
<b><i>CIMA</i></b>	<ol style="list-style-type: none"> <li>1. Establishing the measure 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 measure.</li> </ol>	<ol style="list-style-type: none"> <li>1. Issuing the measure establishes general standards by which all VASPs should conduct their VA business, and will be used as a measure against which the Authority will assess compliance for AML and prudential purposes, consistent with the VASP Law.</li> <li>2. The measure will facilitate sufficient oversight in the transitory/phased implementation of the VASP Law.</li> <li>3. Sets precedent for other jurisdictions as there are limited jurisdictions that have issued statement of principles for the conduct of VA services.</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 measure.</li> <li>2. Gazettal of the measure 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. Reduces risks of registered VASPs not being adequately supervised during the phased implementation of VASP Law.</li> <li>3. Ensures compliance of the jurisdiction with FATF standards (particularly recommendation 15).</li> </ol>
<b><i>VASPs</i></b>	<ol style="list-style-type: none"> <li>1. VASPs may incur some cost to ensure compliance with the general principles. However, these upfront costs will be balanced off as there would be reduced costs to be incurred to ensure compliance when the VASP Law is commenced in full.</li> </ol>	<ol style="list-style-type: none"> <li>1. VASPs will benefit from greater clarity and guidance surrounding the standards to be met for the conduct of their VA operations having regard to the phased implementation of the VASP Law in the first instance.</li> </ol>

**G. Consultation Feedback and Comments**

- 15.** 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.
- 16.** 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.
- 17.** 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>2</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 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>

- 18.** 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.

<sup>2</sup> This example is not reflective of the content of the proposed measure.

## **H. Notice of Representations**

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

- Statement of Principles for the Conduct of Virtual Asset Services

**20.**The Authority must receive consolidated representations by 1700hrs on **16 December 2020**. Representations received after this deadline may not be considered and will not form part of the collated written response provided to private sector associations.

**21.**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)

**22.**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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