

THE FINANCIAL
TECHNOLOGY
LAW REVIEW

SECOND EDITION

Editor
Thomas A Frick

THE LAWREVIEWS

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PREFACE

This is already the second edition of *The Financial Technology Law Review*. Concerns about new developments that blockchain, big data and AI will trigger in the finance sector have not disappeared since the first edition. However, the use of IT in the finance sector is not new and many applications that would be labelled today as fintech are already quite old, at least by today's standards. Financial market participants and their legal advisers already have considerable experience in implementing such changes. As far as improved support products are concerned, the general rules of financial regulations can be applied quite easily to new developments.

Some of the recent developments may already have seen their peak, for example, the great number of cryptocurrencies imitating bitcoin. Others, in particular stablecoins and security tokens, but also robo-advisers and the use of big data, AI and other blockchain applications, may still be at an early stage. They may have the potential to disrupt the industry, at least in some of its sectors. Again, there has been more scepticism, not only in a recent report by the Bank for International Settlements but also in management consultant studies such as 'Blockchain's Occam problem', arguing that blockchain is a technology in search of a problem.

Regulators' surprise about the sheer dynamism of these advances – both the speed of the technical developments and the speed with which such new possibilities were implemented – has ebbed and a number of countries have started to draft (or have already implemented) new laws or changes to their current laws to address fintech issues. This is particularly the case in the area of anti-money laundering rules, a prime concern not only of regulators but also of banks and other financial market participants. Unless the industry can be certain that participating in the crypto-economy will not lead to increased anti-money laundering risks, established financial players remain cautious.

The national solutions chosen (and the speed with which regulators are willing to react by providing guidelines to market participants) varies considerably between jurisdictions. This may be a consequence of different regulatory cultures, but in addition, the existing legal systems may pose varying and unplanned obstacles to the some of the new applications. It may, for example, be difficult to transfer rights on the blockchain if the national code prescribes that rights can only be assigned in writing. Therefore, a structured collection of overviews over certain aspects of fintech law and regulation such as the present one continues to be valuable not only for the international practitioner, but also for anyone who looks for inspiration on how to deal with hitherto unaddressed and unthought-of issues under the national law of any country.

The authors of this publication are from the most widely respected law firms in their jurisdictions. They each have a proven record of experience in the field of fintech; they know

both the law and how it is applied. We hope that you will find their experience invaluable and enlightening when dealing with any of the varied issues fintech raises in the legal and regulatory field.

The emphasis of this collection is on the law and practice of each of the jurisdictions, but discussion of emerging or unsettled issues has been provided where appropriate. The views expressed are those of the authors and not of their firms, of the editor or of the publisher. In a fast-changing environment, every effort has been made to provide the latest intelligence on the current status of the law.

Thomas A Frick

Niederer Kraft Frey

Zurich

April 2019

CAYMAN ISLANDS

*Stephen Nelson*¹

I OVERVIEW

With a long history of embracing financial innovation and providing a home for entrepreneurial technology companies, the Cayman Islands has seen organic development as a financial technology hub. The Islands' regulator, Cayman Islands Monetary Authority (CIMA), has allowed the sector to flourish alongside the country's existing legislative framework, and has pledged to introduce a legislative framework to encourage further development. The year 2018 saw a pullback from utility token (i.e., non securities) offerings and a move toward security token offerings (STOs) and stablecoin (or asset-backed coin) offerings (SCOs). In response to market forces and in order to follow industry best practices, in 2018, crypto-issuers and their offering agents expressed interest in, or sought, regulatory licensing. Similarly, many considered offering coins or tokens that held the backing of fixed assets such as metals and currency.

II REGULATION

i Licensing and marketing

Financial services business

CIMA oversees the regulation of financial services on the island. CIMA was formed by statute and is operated pursuant to the Monetary Authority Law (2018 Revision), and its mission is to protect and enhance the reputation of the Cayman Islands as an international financial centre by fully utilising a team of highly skilled professionals and current technology, to carry out appropriate, effective and efficient supervision and regulation in accordance with relevant international standards and by maintaining a stable currency, including the prudent management of the currency reserve.

Anyone wishing to conduct banking, mutual fund, securities, trust, money services, insurance or companies management business in or from the Cayman Islands will need to register with, be licensed by or seek an exemption from CIMA. CIMA prepares and issues a framework of conduct policies, statements of guidance and rules, and forms that set out both broad principles and detailed requirements to which relevant entities must adhere.

While there is no specific regulation relating to fintech, the most likely of CIMA-regulated business areas to be relevant to financial technology businesses are securities investment business, money services business and mutual funds business. We have set out the basic definitions below; however, depending on the specific facts of a case, there are various

¹ Stephen Nelson is a partner at Collas Crill.

exemptions available that may allow a person to be exempt from the requirement to obtain licensing from CIMA or to approach regulation in a different manner (e.g., registration rather than licensing).

Securities investment business

A person carries on securities investment business if that person is:

- a* dealing in securities:
 - buying, selling, subscribing for or underwriting securities as an agent; or
 - buying, selling, subscribing for or underwriting securities as principal where the person entering into that transaction (1) holds himself or herself out as willing, as principal, to buy, sell or subscribe for securities of the kind to which the transaction relates at prices determined by him or her generally and continuously rather than in respect of each particular transaction; (2) holds himself or herself out as engaging in the business of underwriting securities of the kind to which the transaction relates; or (3) regularly solicits members of the public with the purpose of inducing them, as principals or agents, to buy, sell, subscribe for or underwrite securities and such transaction is entered into as a result of such person having solicited members of the public in that manner;
- b* arranging deals in securities. Making arrangements with a view to:
 - another person (whether as a principal or an agent) buying, selling, subscribing for or underwriting securities; or
 - a person who participates in the arrangements buying, selling, subscribing for or underwriting securities;
- c* managing securities. Managing securities belonging to another person in circumstances involving the exercise of discretion;
- d* advising on securities. Advising a person on securities if the advice is:
 - given to the person in his or her capacity as an investor or potential investor or in his or her capacity as agent for an investor or a potential investor; and
 - advice on the merits of his or her doing any of the following (whether as principal or agent): (1) buying, selling, subscribing for or underwriting a particular security; or (2) exercising any right conferred by a security to buy, sell, subscribe for or underwrite a security;
- e* managing EU connected funds;
- f* marketing EU connected funds; and
- g* acting as depositary of an EU connected fund.

The definition of 'securities' is set out in Schedule 1 to the Securities Investment Business Law (2019 Revision) (SIBL), and includes, in general, shares, instruments creating or acknowledging indebtedness, instruments giving entitlement to securities, certificates representing securities, options, futures and contracts for differences. For a discussion of coins and tokens as securities, see Section V.

A person carrying on securities investment business may operate without applying for a licence and may simply register with CIMA in certain circumstances – typically where the company's clients are limited strictly to high-net-worth and sophisticated persons.

The SIBL offers an exclusion for entities that are carrying on securities investment business (e.g., arranging deals in primary issue of securities) on their own behalf. That said, a Cayman Islands company that is the promoter, arranger or broker of securities of a separate issuer is likely to be caught by the definition and subject to the licensing requirement.

Money services business

Under the Money Services Law (2010 Revision) (MSBL), a person carries on money services business if the person carries on the principal business of any or all of the following:

- a* money transmission;
- b* cheque cashing;
- c* currency exchange;
- d* the issuance, sale or redemption of money orders or traveller's cheques; and
- e* such other services as the Governor in Cabinet may specify by notice published in the Gazette; or
- f* the business of operating as an agent or franchise-holder of a business mentioned in (a) to (e) above.

Currency exchange

The third category of money services business is 'currency exchange', which is generally taken to mean the business of exchanging one currency for another. There is debate as to whether virtual currencies and digital assets comprise currency, a commodity, goods or services, and a view may need to be taken, in respect of the particular virtual currency or digital asset, regarding whether exchange services will be provided in or from within the Cayman Islands. Similarly, for a business that will offer a platform for exchange across digital currency pairs, or exchange from fiat-to-digital currency or vice versa, the MSBL will be important to consider.

To the extent that a financial technology business plans to engage in money service business, they would first need to apply for and receive a money services business licence from CIMA.

Mutual fund business

While atypical for traditional fintech business, if an issuer offers coins or tokens with certain attributes, the operators would need to consider whether there is a need to comply with the provisions of the Mutual Funds Law (2018 Revision) (MFL).

The MFL applies to Cayman Islands entities, formed as collective investment schemes, that issue equities that are redeemable at the option of the holder. In our experience, it is not unusual for a fintech company to issue a redeemable token or coin. Such a company ought to take specific advice as to whether they will be regarded as a mutual fund, and as such will be required to comply with the MFL.

The Companies Law and offering of securities to the public in the Cayman Islands

While not a CIMA-related issue, Section 175 of the Companies Law (2018 Revision) prohibits an exempted company incorporated in the Cayman Islands that is not listed on the Cayman Islands Stock Exchange from making any invitation to the public in the Cayman Islands to subscribe for any of its securities. The definition of 'the public' does not include an offering to other exempted companies and exempted limited partnerships, and so, unless a fintech issuer is doing a focused offering into the Cayman Islands and to its general population, this obligation might not be triggered.

ii Cross-border issues

The Cayman Islands does not have a passporting regime specifically designated for regulated or licensed fintech entities to carry on business in the Cayman Islands.

Typically, in order to carry on business in the Cayman Islands on a domestic basis, a company will need to comply with a suite of domestic laws including, without limitation, the Local Companies (Control) Law (2015 Revision) (LCCL), the Trade and Business Licensing Law 2014, and to the extent any foreign workers are employed, the Immigration Law (2015 Revision).

However, as an alternative for placing operations in Cayman, there is Cayman Enterprise City, which permits incorporation and operation of a Special Economic Zone Company. Tech City Cayman has rapidly grown into a significant tech cluster housing some of the world's leading blockchain and fintech companies.²

Companies within Tech City Cayman Islands benefit from generous concessions granted by the Cayman Islands government (including fast-tracked immigration processing and reduced annual fees), designed to incentivise businesses to set up and operate physical staffed offices in the Cayman Islands.

III DIGITAL IDENTITY AND ONBOARDING

The Electronic Transactions Law 2003 (ETL) bears review when preparing and accepting the terms and conditions or purchase agreement relating to an SCO, STO or any other electronic transaction where offer and acceptance is entirely electronic. The ETL provides that information, documents and contracts (or any provision thereof) shall not be denied legal effector validity solely because they are in electronic form. Evidence of a contract (or provision thereof) shall not be denied admissibility solely because it is in electronic form and electronic signatures are also expressly permitted. The ETL provides flexibility for transactional technologies without the requirement for further statute to be adopted. The ETL also provides a framework for the use of electronic signatures as a digital proof.

IV DIGITAL MARKETS, FUNDING AND PAYMENT SERVICES

i Crowdfunding

CIMA has not adopted a formal position on crowdfunding. That said, to the extent a proposed crowdfunding project overlapped with any of the conventional business areas that require licensing, a proprietor ought to seek advice. In particular, the operator of a crowdfunding business would seek clarification of whether the SIBL or MFL would apply.

ii Collective investment schemes

As noted above, mutual funds are regulated by CIMA under the MFL. In general, only open-ended funds are regulated and must be registered with CIMA. All registered funds must be audited by a firm of auditors approved by CIMA and located in the Cayman Islands (although there is no objection to the field work being done elsewhere). Closed-ended funds and, by way of exception, open-ended funds with no more than 15 investors who, by

² <https://www.caymanenterprisecity.com/cayman-tech-city>.

majority, can appoint or remove the operators of the fund (i.e., directors) are not required to be registered although other regulatory aspects (such as anti-money laundering/combating the financing of terrorism (AML/CFT) regulations) will still apply.

There are three main categories of regulated fund, given below.

Registered mutual funds (MFL Section 4(3))

Funds that require a minimum initial investment of at least US\$100,000 (i.e., those targeted at institutional or sophisticated high net worth investors) or are listed on an approved stock exchange may be registered on filing the following documentation with CIMA:

- a* a prospectus that properly describes the equity interest (i.e., shares) and contains the information necessary to enable a prospective investor to make an informed decision as to whether or not to subscribe;
- b* a registration form (Form MF1) and letters of consent from the auditors and administrator;
- c* an affidavit from the directors of the fund;
- d* evidence of incorporation; and
- e* the prescribed registration fee and the initial administrative filing fee.

The majority of regulated funds in the Cayman Islands fall into this category. We have advised on the launch of regulated funds that invest in whole or in part in digital assets. There is no requirement that the administrator of a registered fund is resident in the Cayman Islands and the emphasis is on self-regulation. The fund must, however, have locally approved auditors.

Administered mutual funds (MF Law section 4(1)(b))

Funds, including those that permit a minimum initial investment of less than US\$100,000, may be established by appointing a licensed mutual fund administrator to provide the principal office of the fund in the Cayman Islands. The administrator has primary regulatory responsibility for the administered fund and has a statutory duty to ensure that the fund is properly administered and that the promoters are of sound reputation. The administrator has a statutory obligation to notify CIMA if it knows or has reason to believe that a fund for which it provides the principal office is or is likely to become insolvent or is carrying on business in a manner that is or is likely to be prejudicial to its investors or creditors. The auditors have a similar statutory obligation as described above for registered funds. Similar documentation to that required for a registered fund must be filed with CIMA by the licensed administrator in respect of an administered fund and the prescribed fee paid.

Licensed mutual funds (MFL Section 4(1)(a))

Funds (typically retail funds) that are established and operated by large, well-known and reputable institutions may apply for a mutual fund licence. CIMA must be satisfied that the promoting institution is of sound reputation and that the fund will be properly administered by fit and proper persons with sufficient expertise before a licence will be granted.

Corporate mutual funds are the most common vehicle and are managed by their directors of which there should be a minimum of two. However, the day-to-day operations of a mutual fund will normally be delegated to other specialist professionals.

Directors of CIMA-regulated mutual funds (along with companies registered as excluded persons under SIBL (each a ‘covered entity’) are required to be registered or licensed with CIMA under the Directors Registration and Licensing Law 2014 (DRLL).

The DRLL distinguishes between professional directors (being a natural person appointed as a director of 20 or more covered entities), corporate directors (being a body corporate appointed as a director of a covered entity) and registered directors (being individuals who are not professional directors). An individual acting as a director of an existing covered entity is required to be registered with CIMA.

Directors not already registered with CIMA under the DRLL must first register for a director account with CIMA via the CIMACONnect portal by providing details, including the name of the covered entity for which they are to act as director.

Regulated mutual funds are required to file the following with CIMA on an annual basis:

- a* prescribed fee to be paid by 15 January; and
- b* audited accounts to be filed within six months of the end of the financial year of the fund.

Promoters and operators of regulated mutual funds (i.e., directors, trustees or general partners, as the case may be) also have a statutory obligation to notify CIMA:

- a* of any change that materially affects the information in the prospectus or the application form of which they are aware, and to file an amended prospectus or amended Form MF1 within 21 days; and
- b* if the registered office or principal office of the fund has changed.

iii Payment services and currency exchange

As noted above, payment services and digital currency exchange are likely to fall under the MSBL. Anyone seeking to operate a payment service or digital currency exchange ought to consider the obligations arising under the MSBL.

V CRYPTOCURRENCIES AND INITIAL COIN OFFERINGS

CIMA has not, to date, issued formal guidance on the issuance and distribution of cryptocurrencies and initial coin offerings (ICOs) and token offerings.

That said, any issuer or arranger of an offering of coins or tokens will need to determine whether the offer constitutes an offering of securities, because it may result in the prior need to apply for and receive a licence from CIMA.

The offering by a token issuer of its own token (notwithstanding the token may represent a security for the purposes of SIBL) is exempt from any licensing requirement. However, if there is (1) any offering of a security to the public in the Cayman Islands; (2) an offering of securities by a Cayman Islands company on behalf of a fintech issuer; or (3) a material carrying on of business in the Cayman Islands, the issuer should seek legal advice to help avoid falling afoul of the LCCL, Companies, immigration laws or SIBL.

VI INTELLECTUAL PROPERTY AND DATA PROTECTION

The Cayman Islands Intellectual Property Office is a division of the Cayman government’s General Registry Division, and allows for registration of trademarks, patents, copyrights and

design rights. Since 2015, the Cayman Islands government has steadily introduced legislative measures with the aim of improving the rights and protections of holders of intellectual property developers and holders, and facilitating further IP-related business in the jurisdiction.

The Cayman Islands does yet not have in force formal data protection legislation. However, the Data Protection Law 2017 (DPL) was passed by the Cayman Islands' Legislative Assembly on 27 March 2017 and will come into effect in September 2019.

Generally, the DPL imposes strict regulations on entities handling personal data (data controllers), while simultaneously giving greater legal entitlements to persons whose data is being processed.

VII YEAR IN REVIEW

The Cayman Islands had a number of developments in 2018, including further industry utilisation of Cayman Islands foundation companies, bolstering of anti-money laundering measures, and introduction of international tax cooperation (economic substance) laws. As a purely observational aspect, we found that in 2018 most banking institutions (including those in the Cayman Islands) were reluctant to become involved with, and open banking relationships for, companies that planned to earn money from fintech or cryptocurrency-related businesses.

Cayman Islands foundation companies became a favourite in 2018 for issuers of SCOs and STOs. Civil law foundations have, from time to time, been used by coin and token issues, either for tax or altruistic reasons. Cayman Islands foundation companies are unique in that they bear characteristics of both civil law foundations (in that they emulate some aspects of trusts) and companies – with a separate legal personality and a settled body of company laws. A multitude of issuers and related industry groups have gravitated toward foundation companies as an incredibly flexible tool for either the issuer vehicle or a corporate governance vehicle for acting on the e-vote of designated coin and token holders.

Recent changes to the Cayman Islands anti-money laundering legislation (the AML Regime), adopted to ensure that it more closely aligns with the revised Financial Action Task Force Recommendations, have:

- a* extended the scope of the AML Regime to apply to unregulated investment entities that are not registered with CIMA, including venture capital, private equity or other closed-ended investment funds, structured finance and investment related insurance entities; and
- b* enhanced the existing AML procedures, including a requirement for the appointment of certain designated officers (AMLCO, MLRO and Deputy MLRO), which now apply to all entities in scope of the AML Regime (such entities are termed 'financial service providers').

In most circumstances, token issuers and any funds investing in cryptoassets will be subject to the AML Register.

Notwithstanding that unregulated entities may not have previously specifically fallen within the scope of the AML Regime, international best practice has prompted most such entities to implement AML and combating of terrorist financing checks, policies and procedures (AML Policies). Unregulated entities will also likely have collected information

on their investors with respect to automatic exchange of information obligations under the Foreign Account Tax Compliance Act and the OECD's Common Reporting Standard, which will assist with respect to the requirements under the AML Regime.

The appointment of a natural person as AMLCO, MLRO and Deputy MLRO for all existing funds was to have been effected in 2018, with notification for any CIMA-registered funds being made to CIMA.

The Cayman Islands government has published new legislation, the International Tax Co-operation (Economic Substance) Law 2018, which came into effect on 1 January 2019 (ESL). Further to this, the Economic Substance for Geographically Mobile Activities Guidance (the Guidance) and the International Tax Co-operation (Economic Substance) (Amendment of Schedule) Regulations 2019 (the Regulations) were published on 22 February 2019, providing additional detail and clarification in respect of the ESL.

The ESL sets out requirements applicable to in-scope Cayman Islands entities (Relevant Entities) that carry on particular activities (Relevant Activities), and that are not tax resident outside of the Cayman Islands, to demonstrate that such entities have 'economic substance' in the Cayman Islands.

The ESL has been passed as part of a move by the Cayman Islands to meet its commitments as a member of the OECD's global Base Erosion and Profit Shifting Inclusive Framework and following consultation between the Cayman Islands government and the EU Code of Conduct Group (the Group), subsequent to assessment by the Group of the tax policies of a range of countries, including the Cayman Islands, and its inclusion in a list of jurisdictions (including the British Virgin Islands, Bermuda, Guernsey, Jersey and the Isle of Man) required to address the Group's concerns in relation to economic substance.

The Cayman Islands Tax Information Authority will be responsible for compliance with the ESL, and it is expected that affected companies (being Cayman tax resident companies that are neither investment funds nor domestic companies) will notify and report directly to this entity starting in 2020.

As we hear from our clients and generally in the industry, Cayman Islands banks, as with many such financial institutions around the globe, are reluctant to open bank accounts for entities that will be exchanging digital assets for fiat currency (and vice versa). Whether the reason is concern over AML/CFT aspects, or pressure from correspondent banking partners, or pressure from shareholders, there does appear to be a dearth of willing banking partners. Our clients are hopeful that greater and broader understanding of the fintech industry and better and thoughtful regulation of the global industry will lead to a more welcoming environment for prospective banking clients.

VIII OUTLOOK AND CONCLUSIONS

We believe that CIMA is keen to take a very practical and commercial approach to STOs, SCOs and fintech in general, in order to maintain Cayman's reputation as a leading finance centre. CIMA has not, as yet, issued any formal guidelines but we understand that CIMA may issue guidance in the future, which will be based on consultations with players in the blockchain industry. CIMA's goal is to develop an effective and business-friendly fintech landscape, which also aligns with international standards as they continue to develop. At the same time, CIMA has stated that its primary concern with fintech offerings is the AML/

CFT-related aspect.³ Such concerns will most certainly make up a large part of the specific guidance once released, and may serve to give comfort to all fintech players and service providers (including banking institutions).

Because the Cayman Islands has a forward-looking regulator, combined with a legislative assembly that has introduced such helpful innovations as the Foundation Companies Law, the Cayman Enterprise City and its successful Special Economic Zone Companies, the many fintech entrepreneurs that seek Cayman Islands as a jurisdiction for business look to be well served in the future.

3 <http://www.cayman.finance/2018/03/cayman-regulator-cimas-take-cryptocurrencies-icos-fintech-regtech-roundtable/>.

ABOUT THE AUTHORS

STEPHEN NELSON

Collas Crill

Steve is a partner practising in the investment funds and corporate and commercial departments. His practice is concentrated on investment funds and corporate finance. His clients include funds, investment managers, fund administrators, banks, family offices, financial houses and early stage companies.

Steve regularly advises investment managers on fund formation, registration with the Cayman Islands Monetary Authority, and listing on the Cayman Islands Stock Exchange. He also has extensive experience in the financing of early stage technology companies.

Prior to joining Collas Crill, Steve practised in Canada with Blake Cassels & Graydon, and before that in Kuwait with Al Sarraf & Al Ruwayeh (in association with Stephenson Harwood).

The 2019 Chambers and Partners Global Guide has designated Steve as an ‘up and coming lawyer’ for Cayman in the field of corporate and finance law.

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