

Q&A: Safe harbours for VASPs - part 1

Insights - 28/03/2024

In 2023, Jersey and the British Virgin Islands passed legislation indicating they were welcoming virtual asset service providers, joining the likes of the Cayman Islands as regulated virtual asset friendly jurisdictions.

Asian Legal Business was keen to hear from our experts on how this will allow virtual asset services providers (**VASPs**) to anchor in these jurisdictions, despite increased regulatory burdens, compliance costs and stringent penalties.

Part one covers the key provisions of each piece of legislation, the challenges financial service providers should expect, and the incentives of these jurisdictions.

The Jersey perspective was provided by partner Alexander Curry, the view from Cayman by counsel Chris Wall, and from BVI by managing associate David Mathews.

Key provisions

Can you elaborate on the key provisions of the virtual asset-related legislation implemented in Jersey, Cayman, and BVI? How do these regulations aim to address the risks associated with virtual assets and ensure compliance with AML frameworks?

Alexander: Operating a virtual asset business in Jersey requires compliance with Jersey's anti-money laundering, countering the financing of terrorism and countering proliferation financing (**AML/CFT/CPF**) regime. This regime creates a framework of active supervision and monitoring of all virtual assets and VASP activities with the sole purpose of reducing the opportunity for abuse for those wishing to exploit the industry for illicit purposes. All virtual asset activities and VASPs are now required to apply to the Jersey Financial Services Commission (**JFSC**) for registration for supervision for AML purposes before commencing with any virtual asset activities.

Applicants are required to provide a business risk assessment, policies and procedures for dealing with the AML risk and be able to demonstrate compliance readiness. AML is of course

not just a gating item – the JFSC has the right to visit the applicant, review transactions, policies and procedures and relevant dates to make sure businesses continue to comply.

Chris: In the wake of increased use of virtual assets, the Virtual Assets (Service Providers) Act (Revised) (together, with regulations made thereunder, the **Cayman VASP Act**), was introduced into Cayman in May 2020 and certain provisions commenced in October 2020. The Cayman VASP Act derives from recommendations made by the Financial Action Task Force (**FATF**) and provides for the regulation of virtual asset businesses and the registration and licensing of persons providing virtual asset services. It is being implemented in two phases:

- Phase 1 focuses on AML/CFT compliance, supervision and enforcement, and other key areas of risk. Under Phase one, entities engaged in virtual asset services must be registered with the Cayman Islands Monetary Authority (**CIMA**).
- Phase 2 refers to the licensing approval process that will begin when the relevant provisions relating to licensing of the Cayman VASP Act come into effect. It is expected Phase 2 will also provide the approval process for virtual asset issuances.

Once Phase 2 is operational, businesses providing custodial services of virtual assets and businesses that operate a virtual asset trading platform will require a licence from, and be regulated by, CIMA. All other persons carrying on virtual asset services will require registration. Depending on the extent of the activities, CIMA may require an applicant to apply for a licence instead. There is currently public consultation on the changes required to the Cayman VASP Act.

David: The BVI Virtual Assets Service Providers Act, 2022 (**BVI VASPA**) came into force in February 2023. It seeks to regulate virtual assets services while still fostering an environment in which businesses can innovate and be successful. The body responsible implementing the BVI VASPA and the supervision of persons regulated under that statute is the BVI Financial Services Commission (**BVI FSC**).

The BVI VASPA generally seeks to regulate activities in which a BVI entity will have custody or control, or come in to power over or possession of, a virtual asset that belongs to another person, such as providing exchange services, hosting wallets, or assisting with transfers. In addition, the provision of a virtual assets custody service, or the operation of a virtual assets exchange, are regulated by the BVI VASPA.

Crucially, unlike many other jurisdictions, the issuance by a BVI entity of a virtual asset is not included in the definition of virtual assets service and so, if a BVI company is involved in a crypto project solely as a token issuer, the BVI VASPA would not require the entity to be regulated in respect of that activity. For this reason, we are seeing many blockchain projects based in jurisdictions all around the world choosing BVI for incorporation for the issuer.

Similarly, a fund investing in virtual assets would generally not require licensing under the BVI

VASPA (although the fund entity would still need to be licensed under the BVI's fund licensing legislation).

An entity regulated under the BVI VASPA is subject to certain reporting requirements, most notably the submission each year to the BVI FSC of audited financial statements and a report detailing the level of compliance by the entity with its obligations. The entity also requires a BVI FSC-approved compliance officer.

An entity undertaking a virtual assets service is subject to the provisions of the BVI Anti-Money Laundering Regulations (**the BVI AMLR**) and the BVI Anti-Money Laundering and Terrorist Financing Code Practice (**the BVI AML Code**). The BVI AML Code has implemented the travel rule and so any licensed VASP must undertake KYC on its clients and any persons to whom they transfer virtual assets. This is mandatory for transactions valued at US\$1,000 or more, or if the transaction has any characteristics that make it high risk (for example, the involvement of a politically exposed person). The VASP will be required to have a money laundering reporting officer.

Challenges

With the adoption of the FATF VASP definition and the expanded scope of entities under the revised legislation, what specific challenges or changes should financial service providers and other entities expect in terms of compliance requirements and licensing for handling virtual assets?

Alexander: All financial service providers and other relevant entities must undertake a regulatory review of all potential new virtual asset business before commencing any transactions. Relevant entities must be prepared to amend their policies and procedures to make provision for AML compliance. This will likely require additional notification to the JFSC but will likely also mean an increase in administrative costs and ongoing compliance with recruitment of additional personnel, training or amendments to specific policies and procedures. Relevant entities will need to implement a risk-based approach to virtual assets which includes collecting and analysing relevant customer data such as IP addresses and detection of IP address anonymisation, among other methods for reducing risk. Regulators require evidence of AML measures that entities are putting in place. The use of a correctly configured blockchain analytics tool to screen wallets and monitor transactions along with improvements to CDD checks provides an important part of that evidence.

Chris: The main challenge is with complying with the "travel rule". However, there are now several high-quality tech solutions available to participants to assist in achieving compliance with this requirement.

Once Phase 2 comes into effect in Cayman, there will be additional obligations for virtual asset

trading platforms, as well as custodians as these will be required to be licensed. It is expected that due to the nature of such services being undertaken by Cayman VASPs, strict prudential requirements will be imposed to ensure customers and their assets are adequately safeguarded under the Phase 2 regime.

David: The greatest challenge a VASP is likely to encounter will be compliance with the BVI's AML regime and implementation of the travel rule. Not only can this be challenging on a practical level, but there is also often significant resistance in the market to providing necessary verification documents. It should be noted, however, that this challenge is not specific to the BVI and will be encountered by virtual asset businesses in almost any jurisdiction in which they are regulated.

Open and welcoming approach

In what ways do these regulatory developments demonstrate a more open and welcoming approach to virtual asset service providers (VASPs) in offshore jurisdictions? Are there particular incentives or benefits that these jurisdictions are aiming to provide to attract VASPs?

Alexander: It is now possible to undertake VA or VASP activities in Jersey in compliance with an AML regime that is in line with FATF standards, which was not previously the case. The Innovation Team at the JFSC work with industry stakeholders and are very approachable and are prepared to work collaboratively with applicants and their advisers. Fees for registration for supervision are also competitive and materially lower than some of the other offshore jurisdictions.

Chris: Cayman has had virtual asset legislation in place for a number of years now, allowing market participants to understand what activities involving virtual assets are regulated. Twenty VASPs have registered with CIMA as of the end of March 2024. Accordingly, this does give comfort that Cayman is experienced in regulating virtual asset structures and has many locally-based experts from lawyers and accountants to AML officers and operational specialists available to assist in the set up and operation of regulated VASPs.

David: The BVI VASPA represents a well-balanced approach to regulation by the FSC. For the most part it sticks closely to FATF recommendations, focusing in a practical manner on AML and other misuse concerns but without implementing harsh, blanket regulation across all aspects of virtual asset activity. To that end, the BVI VASP generally seeks only to regulate those with control or power over virtual assets (or instruments enabling control over them) that belong to another person. In this way, the regulatory influence is aligned with the BVI's existing "TradFi" legislation, which generally only seeks to regulate situations whereby a customer or client has placed trust in a person for the custody or management of their assets. The BVI VASPA does not regulate the offer or issuance of a person's own token or dealing or handling other virtual assets by a person on a proprietary basis (although if this activity was done as a BVI fund then this

would be subject to the BVI's fund regulatory regime).

Read part two of our Q&A, which covers balancing compliance without stifling innovation, how firms can rectify their compliance status, how these jurisdictions are enforcing these new regulations, and recommendations for financial services providers to ensure they are compliant with regulations.

An original version of this article was first published in Asian Legal Business's January and February 2024 Asia edition.

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