

Building blocks for ICOs in the Cayman Islands

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Many established and aspiring enterprises have been exploring the use of initial coin offerings (ICOs) to raise funds and/or encourage the development of software projects on blockchain networks. The issuing vehicle is invariably a newly formed company of one type or another. An early consideration is where to form this issuer. This article considers key features of the Cayman Islands in the context of an ICO and explains why Cayman's strengths make it appealing for well-organised ICOs. At the same time we advise caution in respect of how an ICO issuer will comply with anti-money laundering requirements.

Context

The Cayman Islands is the pre-eminent jurisdiction for establishing international investment fund and finance structures. Cayman's stable and predictable political and legal platform allows participants with diverse needs from different countries to undertake legitimate transactions in a neutral environment. Tax neutrality is important, of course, but so is the fact that the jurisdiction creates a level playing field for all participants. Cayman also boasts world class service providers, fast processing times, a first class infrastructure and a widely admired regulatory regime.

The effect (and to an extent the cause) of this is that Cayman has a predominantly institutional client base. The world's largest financial institutions choose Cayman because of its strong legal and regulatory ethos, not in spite of it. Within the financial world, a Cayman domicile enhances the quality of an offering because stakeholders understand that it applies globally accepted standards to combat illicit activities, within a regulatory framework that is customised to reflect the needs of sophisticated parties.

With this high quality global reputation, it is therefore not surprising that Cayman has seen a flurry of interest and a pipeline of pending projects in the ICO market. Both seasoned investment fund managers and reputable proponents of user controlled networks have been considering and/or selecting Cayman as a jurisdiction to launch an ICO and secure open source software.

Conversely, Cayman's focus on institutional business and its adherence to the highest standards to combat financial crime mean that more speculative ICOs will not find a welcoming home in the jurisdiction.

Genesis Block

We will not "re-hash" what blockchain is or explain how it works: there are many other articles that serve this purpose. We will also not perform the typical legal analysis of a "security", as that term is used and/or inspired by the US Securities Act of 1933.

The initial point of analysis for potential ICO issuers considering Cayman is slightly different than the starting point for ICO issuers in other jurisdictions. In Cayman, the definition of a "security" is set out in the Securities Investment Business Law (Revised) (SIBL). Unlike the definition of a security contained in the US Securities Act, SIBL defines "securities" in a list of instruments that are common in today's financial markets. This list does not include an

equivalent to the expansive concept of an "investment contract", and therefore one does not need to apply the four part Howey test in order to determine whether a token is a security.

Another relevant comparison between SIBL and the US Securities Act of 1933 is the legal consequence of a token being classified as a security. In Cayman it is possible for a token to be classified as a security but for the token issuer nonetheless not to be carrying on "securities investment business".

Clearly any regulatory analysis for an ICO will be fact-dependant. It is also to be understood that the zeitgeist among onshore regulators is to try to bring tokens within their regulatory scope. The Cayman Islands Monetary Authority (CIMA) has not made any public comment about its approach but we know that they are considering the issues. As currently drafted, however, the Cayman legislation allows for a more robust interpretation than may be possible in other jurisdictions and means that many ICOs and Cayman issuers will not be required to be registered or licensed with the Cayman regulator.

"Money" Services

Cayman, like many jurisdictions, has a regulatory and licensing regime that applies to "money services businesses". The modern day use of cryptocurrency and tokens as a means of payment requires ICO issuers to consider the application of relevant money services regulatory regimes.

In the Cayman Islands, "money services businesses" are regulated under the Money Services Law (Revised). Under the Money Services Law, "money services business" includes the business of providing (as a principal business) money transmission or currency exchange.

If an ICO issuer provides, as a principal business, the regulated services, the issuer must apply to CIMA for a license granting the issuer the right to carry out a money services business within the Islands.

Again, the applicability of this law will depend on the particular features of the ICO and the underlying business, but generally we are of the view that the Money Services Law, as drafted, is unlikely to apply to most ICOs.

Clean Crypto

ICO issuers and participants in cryptocurrency markets have a difficult task of balancing the positive features of an open source anonymous network with the need and social good of preventing money-laundering and terrorist financing. In Cayman the prevention of money-laundering and terrorist financing is addressed by the Proceeds of Crime Law (Revised), as supported by the Money Laundering Regulations and the Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing.

The Money Laundering Regulations require those engaged in "relevant financial business" to comply with certain requirements, including to adopt client identification and verification procedures, record keeping procedures, internal reporting procedures and internal control procedures.

The definition of a relevant financial business includes various types of activities, including the following:

- acceptance of deposits and other repayable funds from the public;
- money or value transfer services;
- issuing and managing means of payment (e.g. credit and debit cards, bankers' drafts, electronic money);

- participating in securities issues and the provision of financial services related to such issues;
- money broking;
- safekeeping and administration of cash or liquid securities on behalf of other persons;
- the conduct of securities investment business; and
- otherwise investing, administering or managing funds or money on behalf of other persons.

Given the breadth of these categories, it is probable that most ICO issuers will be engaged in relevant financial business and required to adopt anti-money laundering (AML) procedures. In circumstances where an ICO issuer is not engaged in relevant financial services business (strictly speaking), it would be advisable nonetheless to comply with the AML obligations applicable to relevant financial services businesses. Practically speaking, compliance with AML may be required to secure pre-ICO investment and engage representation by reputable third party service providers. We are cognizant that the anonymous nature of cryptocurrencies may present significant administrative challenges when it comes to implementing the best-crafted AML policies. This conundrum must be addressed by ICO issuers at the outset as it represents one of the greatest areas of vulnerability for their businesses.

Exchange of Information for Tax and UK Regulatory Purposes

Consistent with its global positioning as one of the highest quality jurisdictions, the Cayman Islands has adopted regimes that provide for: (a) the automatic exchange of information for tax purposes (eg. FATCA and CRS) and (b) the establishment of a secure, non-public centralised platform on which beneficial ownership information of "in-scope" companies must be maintained. Generally speaking, these regimes require affected financial institutions and companies to obtain and record information about material shareholders and others who exercise control over the institution or company. We have written extensively about [FATCA](#), [CRS](#) and the [Beneficial Ownership Regime](#) and will not revisit these topics in this article; however, Cayman ICO issuers will need to perform an analysis to determine whether they are affected by these regimes, and comply with all relevant requirements on an initial and ongoing basis.

Crypto Funds

Under the Mutual Funds Law (Revised), there are regulatory and/or license requirements for mutual fund businesses. A "mutual fund" is generally defined to include an entity that issues "equity interests" the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors in the mutual fund to receive profits. In order for an entity to be considered a mutual fund, its "equity interests" must (a) carry an entitlement to receive profits in the company and (b) be redeemable or repurchasable at the option of the issuer. Many ICO issuers issuing appcoins or pseudo-security interests will not be a mutual fund on the basis that their tokens do not carry redemption rights. Where tokens do have redemption rights, however, we would expect a careful fact-specific analysis to be undertaken before concluding that the issuer will fall outside the definition of a "mutual fund" simply by issuing tokens instead of shares.

The Fork

Blockchain technology is used as a means of establishing a definitive ledger or record of information. Ironically, the global legal and regulatory regime surrounding ICOs is far from definitive – which suggests a new block of authority will emerge.

ICOs are novel transactions both in the Cayman Islands and globally, and the analysis of their

legal, regulatory and tax treatment is evolving in numerous jurisdictions. A common feature of many jurisdictions, including Cayman, is that the laws applicable to the financial industry, and the regulatory and judicial interpretation of those laws, wholly or largely pre-dates the development of blockchain technology and cryptocurrencies. Cayman has always been responsive to global shifts and it is likely that the laws and regulatory stance applicable to ICOs in Cayman may change to address concerns that have been voiced in respect of ICOs globally.

Assuming that any such enhancements are in step with wider global developments and align with Cayman's blue-chip focus, it is likely that Cayman will remain attractive for well-planned, properly advised ICOs supporting sustainable, legitimate businesses which are willing to implement an institutional-level compliance culture and infrastructure.

Ogier has established a dedicated Digital, Blockchain and Fintech team to assist clients operating or investing in businesses in the Fintech sector who want to take advantage of the benefits that come with using an offshore structure. Further information about our Digital, Blockchain and Fintech team can be found [here](#).

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