

**APPLEBY**

Q2 2020

**CAYMAN ISLANDS  
REGULATORY UPDATE**



# CONTENTS

Introduction ..... 2

Hot Topics..... 2

Economic Substance and AEOI ..... 8

Appleby’s Cayman Regulatory Team.....11

About Appleby .....12

# INTRODUCTION

Without a doubt 2020 has so far proven to be a year like no other. A pandemic and global dislocation and social upheaval have made for turbulent times indeed. The regulatory environment has seen its fair share of change also, and Appleby Cayman's second quarterly publication of 2020 focuses on bellwether developments, including regulatory impacts of COVID-19, The Virtual Asset (Service Providers) Law 2020, new regulatory measures from the Cayman Islands Monetary Authority (**CIMA**) and the latest on economic substance. We hope you will find its contents useful.

## HOT TOPICS

### THE CAYMAN COVID-19 LANDSCAPE

#### Annual Returns and Economic Substance Filings

The Registrar of Companies (**ROC**) and the Department for International Tax Cooperation (**DITC**) have extended the deadlines for entities to complete their annual returns and their 2019 economic substance notification filings to 30 June 2020.

#### Annual Fee Penalties

Companies and exempted liability partnerships that fail to file their annual returns and/or pay their annual fees by the 30 June 2020 deadline will be subject to penalties as of 1 July 2020. The penalty fee in effect will be 33.33% of the annual fees due. All companies would be subject to the penalty, including limited liability companies and foundation companies.

As of 26 March 2020, the Cayman Islands Government has deferred the obligation to pay annual fees until 30 June 2020 for corporate entities registered in the Cayman Islands. This fees deferral applies to all companies, including limited liability companies and foundation companies.

Exempted liability partnerships (**ELPs**) will also have their annual fees and annual return filings deadline extended until 30 June 2020.

News of the fees deferral accompanies the Ministry of Financial Services' 25 March announcement that the annual return filing deadline for all companies had been extended until 30 June 2020. Companies and ELPs that fail to file their annual returns and/or pay their annual fees by the 30 June 2020 deadline will be subject to penalties as of 1 July 2020.

#### Automatic Exchange of Tax Information (AEOI) Filings

The DITC issued an Industry Advisory on 15 April 2020 which noted a FAQ (FAQ 5 under the heading Reporting) that had been published by the US Internal Revenue Service the day before. That FAQ provided for an extension of time for Model 1 IGA jurisdictions to provide their 2019 FATCA data to the United States competent authority. As a result of this change by the US, the DITC extended the FATCA reporting deadline for the 2019 reporting period to 16 November 2020.

## PRIVATE FUNDS AND LIMITED INVESTOR FUNDS

Operators of existing investment funds not currently registered with the Cayman Islands Monetary Authority (**CIMA**) should consider whether either the Private Funds Law or the Mutual Funds (Amendment) Law applies to their fund, so as to now bring that fund into the scope of CIMA's regulation. The deadline for registration under the Transitional Period is 7 August 2020.

Recommended compliance steps include:

- Consult with Appleby to determine (i) the basis on which the fund was previously excluded from registration with CIMA and (ii) whether registration is now required
- If registration is required:
  - register with CIMA by the applicable deadline
  - engage with your fund's auditors to ensure audit arrangements for the 2020 financial year are put in place

For more information access our prior article [here](#).

On 29 April 2020, the DITC also extended the reporting deadline for Common Reporting Standard (**CRS**) filings to 16 November 2020.

### **Beneficial Ownership Filings**

On 20 April 2020, The Ministry of Financial Services & Home Affairs issued an Industry Advisory notifying that the deadline for the next round of beneficial ownership filings had been extended to 15 May 2020, with the next submission intending to capture the new legal definition for "beneficial owner". Effective 15 May 2020, a beneficial owner under the Companies Law and the Limited Liability Companies Law is one who holds '25% or more' (rather than 'more than 25%') of the shares or voting rights in a company.

### **CIMA**

CIMA published a notice on 25 March 2020 confirming a one-month extension of the filing deadlines for certain regulatory returns with due dates through 30 June 2020. A complete list of those filing extensions can be found [here](#).

There are no fees associated with the recently published extensions for filing regulatory returns. However, all fees remain in effect and are payable upon the relevant regulatory filing being made. CIMA expects that all submissions will be filed on or before the extended deadline, unless otherwise notified.

In lieu of a notarised affidavit, CIMA will accept written confirmation from an operator of a fund, applying to be registered/licensed pursuant to the Mutual Funds Law or Private Funds Law, authorising the registered office or other service provider to file the fund's registration/application on behalf of the operator. CIMA will accept uncertified resolutions that confirm the de-registration/cancellation date of a fund.

On 1 April 2020, CIMA issued a **notice** inviting banking licensees, particularly those providing essential retail services to the local community, to contact CIMA should there be any specific regulatory issues or circumstances that it can assist with, including assistance with regulatory ratios, filing requirements or other regulatory matters, all of which will be considered on a case-by-case basis.

On 21 April 2020, CIMA also issued an advisory to assist regulated entities with AML/CFT compliance during COVID-19. The advisory includes helpful guidance on matters such as possible threats and vulnerabilities and how entities may verify information (both at the time of establishing a relationship or as a part of ongoing customer due diligence) whilst observing curfew, social distancing or self-isolation.

In keeping with the overall uptick in cybercrime during COVID-19, on 2 June 2020 CIMA warned of fraudulent emails in circulation purporting to be from CIMA. The emails contain the subject "CIMA – Due Diligence & Questionnaire Request". Recipients are advised not to click on any links or attachments within such emails. Further details are set forth in CIMA's notice attached [here](#).

More information on CIMA's latest developments can be found [here](#).

## CAYMAN INTRODUCES VIRTUAL ASSETS FRAMEWORK

In recent years the Cayman Islands has become an attractive destination for technology entrepreneurs, particularly those connected with virtual assets. While much of Cayman's financial services legislation was written before the recent blockchain revolution began, recent years have seen the Cayman Islands take a number of legal and regulatory steps to make the jurisdiction one that will allow such innovation to thrive. The Virtual Asset (Service Providers) Law 2020 (**VASP Law**) is the latest legislative development reflecting Cayman's ambition to become a global technology hub.

The VASP Law was passed at the end of May and aims to promote the use of new technology and innovative enterprise in the Cayman Islands while complying with newly adopted international standards set by the Financial Action Task Force (**FATF**). Please note that while the VASP Law has now been passed, it has not yet been brought into force.

### Key Definitions and Requirements

The VASP Law defines a "virtual asset" as a digital representation of value that can be digitally traded or transferred and used for payment or investment purposes, but does not include digital representations of fiat currencies.

"Virtual asset services" are businesses providing one or more of the following services or operations:

- (a) exchange between virtual assets and fiat currencies;
- (b) exchange between one or more other forms of convertible virtual assets;
- (c) transfer of virtual assets;
- (d) virtual asset custody service; or
- (e) the participation in, and provision of, financial services related to a virtual asset issuance or the sale of a virtual asset.

Under the VASP Law virtual asset service providers (**VASPs**) would need to register with, or be licensed by, CIMA. A separate licence from CIMA would be needed for virtual asset custodial services and exchange or trading platforms.

All VASPs would be subject to a number of general obligations including:

- anti-money laundering obligations;
- strict data protection and cyber security obligations in connection with the personal data they process;
- the filing of annual accounts with CIMA as the regulator of VASPs;
- the requirement for senior officers and beneficial owners to be fit and proper persons;
- the prior approval of senior officer appointments by CIMA; and

## OFFSHORE DATA PROTECTION GUIDE

Appleby's Offshore Data Protection Guide provides a detailed overview of the privacy and cyber security regimes in eight of the world's largest offshore jurisdictions with quick linked answers to some of the most business critical issues.

Appleby's global privacy and information management team has cutting-edge expertise in data protection and information security regulation and implementation. The team routinely advises clients on pan-jurisdiction data protection matters and also works frequently with local government, regulators and industry bodies to develop responses to the challenges of globalisation and regulation.

Access our guide [here](#).

- the prior approval of CIMA for any issuance of virtual assets.

Importantly, the VASP Law will provide exemptions for certain activities which are not caught by the registration or licensing requirements. These include:

- platforms which are mere meeting places, where sellers and buyers may post bids and offers and where the parties trade in a peer-to-peer environment only; and
- Fintech service providers that use innovative technology to improve, change or enhance financial services but which are not virtual asset services.

### **Regulatory Sandbox**

For entities or individuals providing a virtual asset service that represents an innovative use of technology or uses an innovative method of delivery that requires supervision and oversight that is not offered by an existing licence or registration, the VASP Law will allow those providers to apply to sit in a new regulatory sandbox. A sandbox licence is a temporary licence granted for a period of up to one year.

To qualify for the sandbox, CIMA will consider whether the service, technology or method of delivery improves the provision of financial services in the Cayman Islands and complies with global standards and best practices for combating money laundering, terrorist financing and proliferation financing.

### **A Note of Caution**

The Cayman Islands proved a popular choice for issuers of virtual assets during the initial coin offering boom of 2017 to 2018. During the “Crypto Winter” that followed, Cayman’s flexible business-orientated legislation, multitude of potential issuer vehicle types, and internationally recognised securities regulatory regime enabled the Islands to pivot away from crowd-funded platforms towards security tokens and stable coins which provide greater value stability and more predictable investment returns. This same flexibility means that Cayman is ideally placed to take advantage of the latest shift towards securitising common assets and decentralised finance (De-Fi) products, with Cayman already being the offshore centre of choice for other securitisation issuers.

Virtual asset providers and those carrying on certain virtual asset activities will wish to take note of the following aspects of the VASP Law as the proposed framework may not be suitable for all providers:

- 1) The advantage of the VASP Law is that it creates a registration and licensing regime that is comprehensive and robust. Those seeking to show the highest level of regulatory compliance and good governance will find this appealing. However, it must be noted that the regime exceeds the requirements of some other leading financial centres, such as the UK’s FATF-compliant framework. The FATF’s recommendations refer to a requirement for licensing and/or registration of VASPs to enable appropriate AML/CTF supervision only. The obligations under the VASP Law go far beyond this.

- 2) The VASP Law is crafted to deter bad actors and carries serious penalties, including imprisonment, for those who fail to comply. Taking high quality, specialised legal advice will be absolutely paramount for clients in this space. In particular, virtual asset service providers will wish to be very clear on their registration requirements, which may not always be straightforward in a fast-moving, innovative business sector. As regards bad actors, there is also a body of criminal law which deals with fraudulent and similar activities, particularly those connected with AML/CTF.
- 3) Some token issuers may not wish to use a licensed trading platform to launch their virtual assets. Such exchange offerings have already fallen out of favour in other jurisdictions due to high fees and other issues and we expect that industry response to this requirement will be negative.
- 4) The prior approval of CIMA must be obtained where ten per cent or more of the total shares or interests (as applicable) in a company or partnership which is a virtual asset service provider are to be issued or transferred. This strict change of control restriction is a common feature under Cayman's other regulatory laws and will be primarily a data collection exercise for licensees and potential transferees. However, it remains to be seen whether the additional administrative burden this requirement creates will deter prospective clients and make Cayman less competitive in this fast moving sector.
- 5) While we await further details, it will be important to ensure that application fees and annual fees - which are not detailed in the VASP Law - are no higher than those levied in competing jurisdictions.

## CIMA RULES AND STATEMENT OF GUIDANCE

CIMA has been prolific in its output this quarter despite COVID-19 working conditions. On 27 May 2020, the following Rules and Statement of Guidance were published:

1. [Rule – Cybersecurity for Regulated Entities](#)
2. [Statement of Guidance – Cybersecurity for Regulated Entities](#)
3. [Rule on Contents of Offering Documents – Regulated Mutual Funds](#)
4. [Rule on Contents of Marketing Material – Registered Private Funds](#)
5. Segregation of Assets – Regulated Mutual Funds
6. Rule on Segregation of Assets – Registered Private Funds

## Cybersecurity

The new Rule and Statement of Guidance in relation to cybersecurity do not come into force until six months after their publication date. However, the contents of these measures have been published now to permit sufficient time for regulated entities to take necessary steps to comply. The new Rule applies to entities regulated by CIMA under the Banks and Trust Companies Law (including “controlled subsidiaries”); the Insurance Law (limited application to Class B, C and D insurers); the Mutual Funds Law (but not “regulated mutual funds”); the Securities Investment Business Law; the Building Societies Law; the Cooperative Societies Law; the Development Bank Law; the Money Services Law; the Companies Management Law; the Directors Registration and Licensing Law; and the Private Trust Companies Law.

The Rule includes a host of definitions, such as “cyber risk”, “cybersecurity” “cybersecurity breach”, “cyber incident” and “cybersecurity threat”, and also sets out prescriptive rules in relation to a regulated entity’s cybersecurity framework. Regulated entities must demonstrate that data protection is part of their strategy and that their cybersecurity framework takes into consideration the provisions of the Data Protection Law (**DPL**). Our prior article on the DPL is available [here](#).

The Statement of Guidance supplements the Rule by providing detailed guidance on implementing Rule requirements, including in relation to risk identification and assessment, risk monitoring and reporting, incident response, containment and recovery, use of the internet, employee training and awareness, outsourcing arrangements and data protection.

A regulated entity’s cybersecurity policies and procedures are expected to be documented and subjected to internal audit or assessment.

## Contents of Offering Documents/Marketing Materials

The Rule on Contents of Offering Documents – Regulated Funds replaces the earlier rule of the same name. The Rule applies to funds licensed or registered under s. 4 of the Mutual Funds Law (including the new category of Limited Investor Funds). As the name suggests, this rule lists the information CIMA requires to be included within any “Offering Document” prepared in accordance with the requirements of the Mutual Funds Law.

The Rule on Contents of Marketing Materials – Registered Private Funds is a new mirror rule to the rule above but which instead applies to funds registered under section 7 of the Private Funds Law (other than Alternative Investment Vehicles).

## Segregation of Assets

Each of the new Rules in relation to segregation of assets is aimed at ensuring the safekeeping of investor (fund) assets from assets of the fund’s service providers. In the private funds context, segregation is achieved through the requirement that fund assets be held by a custodian and the Rule focuses on accounting for fund assets separately from those of the manager or operator or custodian. The Rule for regulated mutual funds acknowledges the portfolio involvement of more numerous service providers - the administrator, auditor, custodian, investment manager, operator, prime broker, promoter, registrar or any of their delegates. **Following publication of these Rules, CIMA received comments from Industry. We understand the comments are being considered and the Rules may be revised. As such, hyperlinks to these Rules will be included in our next Quarterly Regulatory Update.**



# ECONOMIC SUBSTANCE AND AEOI

*The article below is a reproduction (with minor amendments) of an article first published on 2 June 2020. We note that since the original publication date, the Coronavirus has been largely controlled in the Cayman Islands, and restrictions for suppressing COVID-19 are now minimal. Offices have been permitted to re-open, but social distancing is still required and face masks are mandatory where social distancing is difficult. The borders, however, remain closed. Whilst business conditions continue to improve, challenges remain and it is important to bear in mind that an entity that is required to meet an economic substance test under the ES Law for the 2020 financial year is required to do so for the duration of the calendar year.*

## ECONOMIC SUBSTANCE IN THE TIME OF COVID-19

The International Tax Co-operation (Economic Substance) Law (Revised) (**ES Law**) came into force in the Cayman Islands (the **Islands**) on 1 January 2019.

Under the ES Law a “relevant entity” conducting any “relevant activity” is required to satisfy a 3-branch economic substance test (the **ES Test**) in respect of that activity. It must:

1. conduct Cayman Islands core income-generating activity in relation to that relevant activity;
2. be directed and managed in an appropriate manner in the Islands in relation to that activity;
3. having regard to the level of relevant income derived from the relevant activity carried out in the Islands –
  - have an adequate amount of operating expenditure incurred in the Islands;
  - have adequate physical presence (including maintaining a place of business or plant, property and equipment) in the Islands; and
  - have an adequate number of full-time employees or other personnel with appropriate qualifications in the Islands.

Cayman, like many other jurisdictions, introduced the ES Law in response to international pressure to demonstrate ‘substance’ for entities established within its tax neutral borders. It goes without saying that drafters of the ES Law did not have COVID-19 in their thoughts when formulating the ES Test. Who but an elite group of epidemiologists and pandemic experts did? The reality is that the ES Law continues to impose certain obligations on ‘relevant entities’ carrying on ‘relevant activities’, and in so doing, it raises the spectre of how does, or can, an entity comply with these obligations in the face of disruption as unprecedented as COVID-19?

Consider the case of a newly-incorporated Cayman Islands exempted company (**Cayco**), intent on carrying on a relevant activity and therefore required to meet the ES Test from the time of commencing its business activities. How would Cayco satisfy each prong of the ES Test in the current environment?

With borders closed and many businesses shuttered for the foreseeable future, commencing operations through physical premises in the Cayman Islands is likely to prove nearly impossible at this time. Fortunately, the ES

Law does provide for the outsourcing of core income-generating activities to another provider within the jurisdiction, so long as the relevant entity is able to monitor and control the carrying out of that activity by that other person.

Core income-generating activities are specific to the type of relevant activity in which Cayco will engage. Within some sectors, such as those related to financial services, Cayman-based outsourcing options have been steadily expanding. However, even where outsourcing is viable, Cayco may find it challenging to assess its outsourcing options and settle on an appropriate partner in such uncertain times.

With respect to the “directed and managed” prong of the ES Test, on 21 March 2020 the DITC (through a Ministry of Financial Services industry update) acknowledged that COVID-19 may impact travel in 2020, which may in turn affect the ability of some entities to hold their board of directors meetings in Cayman during the year. The DITC went on to confirm that “where the board of director meetings are required to be held virtually during this period of uncertainty, the DITC will take that into consideration on a case-by-case basis when determining whether an entity has passed or failed the ES test in reporting, which is due in 2021”.

By its nature, the final prong of the ES Test is a measure of proportionality – “having regard to the level of relevant income”. If Cayco has relevant income, it will have to assess whether its operating expenditure, premises and employees are adequate in relation to that income. In an era where hiring freezes and layoffs are the norm, work permit applications are largely on hold, commercial properties may only be shown via video and where many non-Caymanian residents within the Islands find themselves by necessity exploring a return to their home countries, how does Cayco successfully ramp up its operations, ensuring all the while that it is well positioned to comply with the ES Test? The problem is decidedly more acute where Cayco’s business operations require those with specific skill sets, already in short supply.

In late March the DITC announced an extension to the 2019 ES notification filing deadline from 31 March 2020 to 30 June 2020. That move, coupled with its pronouncement on board meetings during 2020, demonstrate DITC’s appreciation for the challenges facing existing market participants. All indications appear to be pointing to COVID-19 continuing to dominate economies the world over for the balance of this year and possibly into 2021. It remains to be seen whether the DITC will revisit the ES Test to address market realities and the new economic landscape.

## ES GUIDANCE NOTES

The ES Law is supplemented by the Cayman Islands guidance for economic substance for geographically mobile activities (**ES Guidance Notes**), version 2.0 of which was published on 30 April 2019. We had anticipated publication of the final version 3.0 of the ES Guidance Notes during 2019, following the release of a consultation draft in late November of that year, but no such publication occurred. Publication of the updated ES Guidance Notes is, however, expected to occur at any time. We encourage clients to remain alert to the anticipated release of the new ES Guidance Notes during 2020.

## NEW ES FORMS

On 15 May 2020, the DITC released two new ES forms and accompanying notes:

### **Outsource Service Providers (OSPs)**

Domestic outsourcing is permitted under the ES Law. To enable any claims of outsourcing by a relevant entity on its ES return (report) to be verified, the Tax Information Authority will require confirmation from the OSP using this [form](#).

For assistance, please refer to the [guidance notes](#).

### **Entity Tax Resident in Another Jurisdiction**

All entities which confirmed on the ES notification form that they are carrying on a relevant activity but selected the “tax resident outside the Islands” option are required to complete this [form](#).

For assistance, please refer to the [guidance notes](#).

## ES NOTIFICATION AND REPORTING

With the final extension deadline for filing of notification forms under the ES Law upon us at 30 June 2020, attention is now expected to turn to reporting for the 2019 financial year. Only relevant entities carrying on relevant activities are required to meet an ES Test, and so it is only those entities that will also be required to report under the ES Law. Detailed reporting forms are expected in Q3 2020.

## AEOI FILINGS

As noted above, on 15 April 2020, the DITC extended the FATCA reporting deadline for the 2019 reporting period to 16 November 2020.

On 29 April 2020, the DITC also extended the reporting deadline for CRS filings to 16 November 2020.

The Cayman Islands Automatic Exchange of Information (**AEOI**) Portal is currently offline. We await the launch date for the new DITC Portal, which will facilitate not only AEOI reporting but also economic substance reporting and later in the year country-by-country reporting.

## APPLEBY CAYMAN'S REGULATORY TEAM



### JENNIFER PARSONS

+1 345 814 2702

[jparsons@applebyglobal.com](mailto:jparsons@applebyglobal.com)

Jennifer is Counsel in the Corporate Group at Appleby. She specialises in providing regulatory advice to clients within the banking, investment fund and fund administration, insurance and securities sectors.

Jennifer also has extensive experience advising hedge funds, hybrid funds and private equity funds, top tier investment managers, administrators and other fund service providers on all aspects of fund formation, ongoing regulation and compliance, restructuring and termination.



### PETER COLEGATE

+1 345 814 2745

[pcolegate@applebyglobal.com](mailto:pcolegate@applebyglobal.com)

Peter Colegate is Counsel in the Corporate Group and co-head of Appleby's Global Technology and Innovation Group. His practice is focused on privacy, data protection and strategic corporate-commercial and regulatory work in the technology and innovation sectors.

Peter has a keen interest in emerging technologies and has worked on numerous blockchain based token offerings and smart contract projects across multiple jurisdictions. A privacy and data protection specialist, Peter is a member of the International Association of Privacy Professionals and sits on the Cayman Islands Government's Working Group on Data Protection. Peter has written and spoken extensively about privacy, data protection and new technologies across Asia and the Caribbean region, recognising that regulatory issues are often the threshold question for new business models, products and services. He is a member of the Financial Services Legislative Committee Fintech Sub-Committee, the Cayman Finance Fintech Innovation Lab, the Cayman Islands Blockchain Association and the Fintech Professionals Association.



## SIMON RAFTOPOULOS

+1 345 814 2748

sraftopoulos@applebyglobal.com

Simon Raftopoulos is a partner and a member of the Corporate Finance and Private Equity teams. He represents clients in a wide variety of corporate finance transactions, including private equity and fund finance, joint ventures, mergers, acquisitions, leveraged buyouts, initial and secondary public offerings and private placements of equity and debt securities. Simon also represents clients on large private equity transactions and his team has a deep PE formation and transactional presence in Cayman.

For 2020, Simon has been recognised by Who's Who Legal as one of the world's leading banking lawyers and ranked as a 'market leader' in IFLR1000. Chambers Global described him as a "brilliant lawyer, with excellent and creative ideas for complex issues". For 2019 he is ranked as a 'leading individual' and in 2018, he was a 'recommended' lawyer in Legal 500 and described as "very technically sound, a problem-solver and extremely knowledgeable on Cayman law" in Chambers Global.

## ABOUT APPLEBY

Appleby is one of the world's leading international law firms. Our global teams of legal specialists advise public and private companies, financial institutions and private individuals. We are a full service law firm providing comprehensive, expert advice and services across corporate, dispute resolution, property, regulatory, and private client and trusts practice areas. We work with our clients to achieve practical solutions, whether from a single location or across multiple jurisdictions. We operate in 10 highly regarded and well-regulated global locations. These include the key international jurisdictions of the Cayman Islands, Bermuda, the British Virgin Islands, Guernsey, Isle of Man, Jersey, Mauritius, and the Seychelles, as well as the international financial centres of Hong Kong and Shanghai. Our global presence enables us to provide comprehensive, multi-jurisdictional legal advice at the times most beneficial to our clients. We are regularly recognised for our professionalism, integrity and excellent client service, and these are the values we pride ourselves on and are at the core of our business.

© Appleby Global Services 2020.  
This publication is for general guidance only and does not constitute definitive advice.

---

Clifton House  
71 Fort Street  
PO Box 190  
Grand Cayman KY1-1104  
Cayman Islands

T: +1 345 949 4900

E: cayman@applebyglobal.com

---