

Cryptocurrency and distributed ledger technology

By Richard Spencer

The stratospheric rise in the value of cryptocurrencies throughout 2017, coupled with significant price volatility, caught the attention of the world at large. Opinions remain polarised, with regulators warning “Main Street investors” of the risks associated with purchasing virtual currencies and cryptographic tokens. The underlying distributed ledger technology is far less controversial, with well-known global financial institutions investing heavily in this space.

Investment managers looking to launch crypto-focused investment funds aimed at professional investors often wish to set up a standalone, master-feeder or mini-master fund structure in the Cayman Islands. With many global digital asset and virtual currency exchanges preferring offshore counterparties, managers of domestic funds also find themselves establishing Cayman Islands vehicles.

Typical considerations that arise when establishing a crypto-focused investment fund include whether to accept crypto-denominated subscriptions from investors and how best to implement a satisfactory custody solution.

Fund managers often wish to have the flexibility to invest in a wide range of digital assets, including liquid cryptocurrencies and illiquid tokens, and also to acquire equity interests in blockchain oriented businesses. In this regard, it is important to ensure that the fund documents include appropriate redemption and valuation mechanisms, and to consider the implementation of side pockets at the outset. In addition, fund managers must keep abreast of developments in the global legal and regulatory landscape that may impact their investments in tokenised securities and other digital assets.

As recently as early 2017, only a handful of boutique service providers were available to crypto-focused investment funds, but we have seen the larger fund administration and audit



Richard Spencer, Partner,
Campbells Legal

firms move into this space in recent months. Fund managers may also consider engaging service providers that utilise blockchain technology, and will need to weigh up the advantages and disadvantages in doing so. Proponents of blockchain technology cite fraud-proof record keeping as a key advantage, by virtue of the immutable nature of data in a blockchain, and point to consequential cost-savings. Others are concerned that blockchain services and solutions have not been stress-tested, as they are still in their infancy.

The Cayman Islands’ legal and regulatory landscape supports the development and monetisation of distributed ledger technology. The Electronic Transactions Law and the recently revised trade mark registration regime complement the “zero tax” status of Cayman Islands exempted companies.

Global distributed ledger technology businesses are increasingly considering whether to establish a physical presence in the Cayman Islands. Such businesses can often benefit from a fast-track trade licensing process that is aimed at attracting software developers and computer programmers to the Cayman Islands, with a view to diversifying the Cayman Islands economy. Coupled with developments in cloud computing and the Cayman Islands’ geographical proximity to the United States, we are finding that establishing a Cayman Islands office is very appealing to both established global businesses and individual entrepreneurs.

Having worked with the first movers in this space, we are delighted to see the Cayman Islands emerge as the jurisdiction of choice for crypto-focused investment funds and the development and monetisation of the underlying distributed ledger technology. With significant resources being deployed to develop this technology, the Cayman Islands are well positioned to provide an ecosystem that is conducive to the proliferation of crypto-focused investment funds and blockchain technology. ■