

## Taylor Swift shakes off FTX sponsorship deal: when can a virtual asset be a security under Cayman legislation?

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News hit the headlines<sup>[1]</sup> earlier this year about Taylor Swift refusing a sponsorship deal valued at \$100 million with now bankrupt cryptocurrency exchange FTX, reportedly due to concerns about whether digital assets<sup>[2]</sup> representing part of the sponsorship package could constitute securities under relevant US legislation, which are subject to their own regulatory requirements.

This article considers the circumstances in which virtual assets may be considered securities under Cayman Islands legislation.

### Introduction

Many jurisdictions have been slow to adopt a modern legal framework to regulate the treatment of digital assets, in part due to the novelty of the technology which underpins them. In the absence of prescribed definitions with which to classify classes of digital assets, jurisdictions have applied existing legal principles to them, for instance classifying digital assets as currencies<sup>[3]</sup>, commodities<sup>[4]</sup> or other non-tangible assets. This approach has resulted in inconsistent treatment of similar assets by industry participants, including tax authorities and regulators<sup>[5]</sup>. The result is manifest uncertainty for key stakeholders and their advisors.

By contrast, Cayman has adopted a proactive approach to the growing digital asset industry and has implemented a comprehensive legal framework providing certainty over the treatment of digital assets and securities, stimulating growth in the Cayman digital asset space. While issues of taxonomy of digital assets are complex and warrant separate consideration, this article provides a high-level explanation of the measures in place in Cayman to provide clarity to practitioners about what constitutes a digital asset, and the circumstances in which a digital asset could be classified as a security, potentially requiring additional regulatory compliance.

## What is a virtual asset?

In order to avoid uncertainty for participants in the digital asset industry, and to ensure the effective policing of virtual asset service providers (which includes, but not limited to, virtual asset trading platforms, virtual asset custodians, as well as the issuers of virtual assets) (VASPs), the Cayman Islands enacted the Virtual Asset (Service Providers) Act (Revised) (the VASP Act), which clearly defines what constitutes a virtual asset and imposes regulatory requirements for VASPs operating in the virtual asset industry in or from within the Cayman Islands. The VASP Act is a direct response to guidance issued by the Financial Action Task Force (FATF) and in particular implements FATF's recommended definition for the classification of virtual assets:

Virtual Asset means "a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes but does not include a digital representation of fiat currencies"[6].

The VASP Act is being implemented in two phases in the Cayman Islands:

### Phase 1

Phase one focuses on AML/CFT compliance, supervision and enforcement, and other key areas of risk. Under Phase 1, entities engaging in or wishing to engage in virtual asset services must be registered with the Cayman Islands Monetary Authority (CIMA), the responsible authority under the VASP Act.

### Phase 2

Phase two refers to the licensing approval process that will begin when the relevant provisions relating to licensing of VASPs come into effect under the VASP Act. Certain provisions pertaining to the virtual asset issuances are also covered by this Phase 2. It is expected that Phase 2 will come into force in the second half of 2023.

## When can a virtual asset also be a security?

The Security Investment Business Act 2020, Revised (SIBA)[7] defines securities as:

**Security** means assets, rights or interests contained in Schedule 1 to SIBA, including the following broad asset classes (with further guidance provided in the schedule to SIBA): shares, instruments creating or acknowledging indebtedness, instruments giving entitlements to securities, certificates representing certain securities, options, futures and contracts for differences.

SIBA specifically states that a "Security" includes virtual assets which can be sold, traded or exchanged immediately or at any time in the future that (a) represent or can be converted into any of the securities listed in paragraphs 1 to 13 of Schedule 1 to SIBA; or (b) represent a

derivative of any of the securities listed in paragraphs 1 to 13 of Schedule 1 to SIBA.

Further guidance as to the judicial treatment of the statutory definition of securities can be found in case law from the Grand Court of the Cayman Islands<sup>[8]</sup>.

Accordingly, to understand whether a virtual asset could be classified as a security, regard must be had to the nature of the asset and whether it represents or can be converted into, or is a derivative of, among others, shares in a company, interests in an exempted limited partnership or limited partnership or units of participation in unit trusts.

If the virtual asset represents an interest in an investment vehicle, advisors would need to consider the application of the Mutual Funds Act, Revised which places additional regulatory requirements on in-scope funds.

## Assistance from the regulator

VASPs can also seek assistance from CIMA for determination of whether virtual assets which they anticipate issuing, or in respect of which they anticipate providing virtual asset services, are likely to be classified as securities or virtual assets.

Virtual asset issuers are required to be registered and, following the implementation of Phase 2, get approval from CIMA before the issuance of new virtual assets to the public over a to-be-determined prescribed threshold. As part of that anticipated process, the VASP Act requires that service providers provide CIMA with sufficient information to have a comprehensive understanding of anticipated virtual assets prior to issue<sup>[9]</sup>, and in particular to understand how the issuer intends to comply with its regulatory obligations with respect to the asset issuance as well as the likely market for the virtual assets. During the approval process, CIMA is required to consider whether the proposed virtual assets will represent securities for the purpose of SIBA<sup>[10]</sup>.

The approval process for the issuance of new virtual assets, once Phase 2 comes into effect, is intended to provide certainty about the nature and regulatory environment applicable to those assets for virtual assets issuers and other service providers, and is a further example of proactive steps taken by the Cayman Islands to ensure that appropriate regulatory safeguards are in place to protect the virtual asset industry.

In addition, currently under the VASP Act, CIMA may require any VASP to apply for a license under any other regulatory law and, further, there is an explicit prohibition on VASPs engaging in securities investment business unless the person is registered or is a licensee under SIBA or has been exempted from registration or licensing by CIMA under SIBA.

## Conclusion

Despite clear statutory guidance on when virtual assets may constitute securities as well as additional guidance on judicial interpretation of the applicable provisions found in Cayman jurisprudence, significant care should be taken in the classification of virtual assets given the potential regulatory penalties for getting the classification wrong.

It should be noted that whilst Cayman Islands legislation defines securities to include certain virtual assets, activities relating to the offering, sale, issuance, dealing, brokerage, custody, exchange and trading of virtual assets as a matter of laws other than Cayman, may result in a different determination (for example, notwithstanding whether the virtual asset is a virtual asset under the VASP Act and not a security under SIBA, such asset may be determined by a regulator such as the US Securities and Exchange Commission to be a “security” as a matter of US law).

Ogier’s global Technology and Web3 team is regularly instructed to provide structuring or regulatory assistance to stakeholders in the virtual asset industry, as well as advising on disputes arising from virtual assets. Please get in touch with your usual Ogier contact, or those listed below, should you have any further questions.

[1] [Taylor Swift had talks with imploded crypto group FTX about NFT ticketing arrangement \(nme.com\)](#)

[2] The use of “virtual assets” and “digital assets” are used interchangeably throughout this article.

[3] See for instance El Salvador’s decision to adopt bitcoin as an official currency.

[4] The US Commodity Futures Trading Commission (CFTC) alleges that certain digital assets including certain cryptocurrencies, and fiat-backed stablecoins are commodities under section 1a(9) of the Commodity Exchange Act, 7 USC § 1a(9); per paragraph 24 of the CFTC complaint filed against Changpeng Zhao and three Binance entities on 27 March 2023 (Civil Action No. 1:23-cv-01887).

[5] While the CFTC maintains that certain digital assets are commodities, the US Securities and Exchange Commission (SEC) also claims that certain digital assets constitute “*investment contracts*” and thereby securities, which fall to be regulated under the Securities Act and the Exchange Act, illustrated by the recent SEC complaint filed against Changpeng Zhao and three Binance entities on 5 June 2023 (Civil Action No. 1:23-cv-01599).

[6] s2(1), VASP.

[7] See section Schedule 1, SIBA.

[8] See for example Paradigm Holdings Limited [2004-05 CILR 542] where the Court held that a wine

forwarding contact was classified as a security under SIBA.

[9] Section 23(1), VASP.

[10] See section 23(1)(d), VASP.

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