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Cayman Islands: Assessment of the Supervision and Regulation of the Financial Sector—Volume II—Detailed Assessment of Observance of Standards and Codes

This detailed assessment of the observance of standards and codes in the financial sector of the **Cayman Islands** in the context of the offshore financial center program contains technical advice and recommendations given by the staff team of the International Monetary Fund in response to a request by the authorities of the **Cayman Islands** for technical assistance. It is based on the information available at the time it was completed in **March 2005.** The staff's overall assessment relating to financial sector regulation and supervision can be found in Volume I. The views expressed in these documents are those of the staff team and do not necessarily reflect the views of the government of the **Cayman Islands** or the Executive Board of the IMF.

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ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR

Volume II: Detailed Assessment of Observance of Standards and Codes

Cayman Islands

March 2005

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Acronyms

AML	Anti-money laundering
BCP	Basel Core Principles for Effective Banking Supervision
BSD	Banking Supervision Division of CIMA
BTCL	Bank and Trust Companies Law (2003 Revision)
BTCLAF	Banks and Trust Companies (License Application and Fees) Regulation
CFT	Combating the financing of terrorism
CI	Cayman Islands
CIMA	Cayman Islands Monetary Authority
CPC	Criminal Procedure Code
CRPL	Confidential Relationship Preservation Law (1995 Revision)
CSX	Cayman stock exchange
EPOJ	Evidence (Proceedings in Other Jurisdictions) (Cayman Islands) Order 1978
EU	European Union
FATF	Financial Action Task Force
FIU	financial intelligence unit
FRA	Financial Reporting Authority
FSPs	financial service providers
FT	financing of terrorism
GN	Guidance Notes
IAIS	International Association of Insurance Supervisors
ICSFT	International Convention for the Suppression of the Financing of Terrorism
IOSCO	International Organization of Securities Commissions
JIU	Joint Intelligence Unit
KYC	know your customer
OFC	offshore financial center
OT	Overseas Territories
MAL	Monetary Authority Law (2003 Revision) *
MDL	Misuse of Drugs Law (2000 Revision)
MDICL	Misuse of Drugs (International Cooperation) Law, 1997
MFAs	mutual funds administrators
MFL	Mutual Funds Law (2003 revision)
MFD	Monetary and Financial Systems Department, IMF
ML	money laundering
MLAT	Mutual Legal Assistance Treaty
MLAUSL	Mutual Legal Assistance (United States) Law
MLR	Proceeds of Criminal Conduct Money Laundering Regulations, 2003
MLRO	money laundering reporting officer
NAV	net asset values
PCA	U.K. Proceeds of Crime Act
PCCL	The Proceeds of Criminal Conduct Law (2001 revision)
RCIP	Royal Cayman Islands Police
SAR	suspicious activity report
SIBL	Securities Investment Business Law (2003 Revision)

SROs	Self regulatory organizations
TF Convention	International Convention for the Suppression of the Financing of Terrorism
TL	Terrorism Law 2003
TUNMOTO	The Terrorism (United Nations Measures) (Overseas Territories) Order 2001
WCCIT	White Collar Crime Investigative Team

* The report contains several references to section 49 of the MAL. This section has been renumbered section 50 in the 2004 revision of the Law.

I. Basel Core Principles for Effective Banking Supervision

A. General

1. With the agreement of the Cayman Islands Monetary Authority (CIMA), the mission assessed compliance with the Basel Core Principles for Effective Banking Supervision (BCP) using the Core Principles Methodology. The assessment was undertaken in the context of the Offshore Financial Center (OFC) Assessment Program. The domestic and offshore sectors were not subject to individual assessments, since they are both covered by the same legislation and supervised by the Banking Supervision Division (BSD) of CIMA. The assessment took place in September and October 2003, and was undertaken by Timothy Sullivan, formerly with the Office of the Comptroller of the Currency, and Stefan Niessner, Deutsche Bundesbank.

Information and methodology used for assessment

2. The assessment of fulfillment of the core principles is not, and is not intended to be, an exact science. Banking systems differ from one country to the next, as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices of supervision are swiftly evolving. Nevertheless, it is internationally acknowledged that the core principles are seen as minimum standards.

3. This assessment of compliance with each principle has been made on a qualitative basis. A five-part assessment system is used: compliant, largely compliant, materially noncompliant, noncompliant, and not applicable. To achieve a "compliant" assessment with a Principle, all "essential" criteria generally must be met without any significant deficiencies. There may be instances where a country can demonstrate that the principle has been achieved through different means. Conversely, due to specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the principle, and therefore, one or more additional criteria and/or other measures may also be deemed necessary by the assessor to judge that compliance is achieved. A "largely compliant" assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially non-compliant assessment" is given when the shortcoming is sufficient to raise doubts about the authority's ability to achieve compliance, but substantive progress had been made. A "non-compliant" assessment is given when no substantive progress towards compliance has been achieved, or when insufficient information was available to allow a reliable determination that substantive progress had been made towards compliance. An assessment of "Not applicable" is rendered for a principle deemed by the assessors to not have relevance."

4. The assessment was based on a review of the applicable laws, regulations, prudential guidelines, and discussions with staff of CIMA (primarily the head of the BSD and her deputies and BSD's legal council). The assessors also met with representatives of individual financial institutions, lawyers, and accountants. Where relevant, a review was also undertaken of CIMA's on- and off-site manuals, statistical and other reporting forms, anonymous prudential reports of individual banks prepared by CIMA, and Rules and Statement of Guidance under preparation. Before the mission, the Cayman Islands had prepared a formal self-assessment.

Institutional and macroprudential setting, market structure—overview

5. CIMA is responsible for the licensing and supervision of the domestic banking sector as well as offshore banks. CIMA's BSD employs well-trained and experienced staff. It carries out its responsibilities through a combination of routine off-site surveillance, based on a quarterly reporting system, and an on-site inspections program. CIMA can address compliance with laws as well as safety and soundness concerns. Arrangements for sharing information with foreign supervisors are in place.

6. There are three different kinds of banks conducting banking business in the Cayman Islands. Category "A"-Banks may carry on banking business within and outside the Cayman Islands (30 at the end of 2002). Among the"A"-Banks are one domestically-owned bank, Cayman National Bank, and four international banks serving the domestic market. These banks are universal banks offering both banking and investment services, including mutual funds. "B"-Banks may carry on banking business with the restriction that the bank is not allowed to take deposits from any person resident in the Cayman Islands other than from another bank and invest in any asset which represents a claim on any person resident in the Cayman Islands except, for example, for transactions with another bank or the purchase of securities issued by the government (353). CIMA may impose the restriction to the "B"-license that the holder of the license shall not receive or solicit funds by way of trade or business from persons other than those listed in any undertaking accompanying the application for the license, in particular for their own group only (Restricted "B" Bank, 5). The majority of the predominant U.S. banks provide overnight accounts to pay clients more favorable interest rates through the offshore branch (sweep accounts). Besides banking services, the international active banks offer advisory brokerage, investment management, trusts, SPV products, custodial services, and corporate services. The banking services are offered to a large extent to facilitate these other services.

7. Assets from local banks increased from C$641 million in 1998 to C$1.1 billion in 2002. The total international assets and liabilities held by banks in the Cayman Islands were US$1.04 trillion, of which 70 percent originate from the Americas. Banks usually maintain capital that is well above the minimum capital adequacy ratio of 12 percent for subsidiaries of banks that are licensed in a country or territory outside the Cayman Islands and 15 percent for privately owned banks. Data on the return on assets and return on equity were not available.

General preconditions for effective banking supervision

8. Preconditions for effective banking supervision in the Cayman Islands are generally in place. Currently, there are no macroeconomic vulnerabilities and risks that could have implications for the effectiveness of prudential safeguards or the stability of the financial system. The public infrastructure provides for an environment that fosters the honoring and enforcement of financial contracts. There is a comprehensive set of laws, which governs the financial sector. These laws are supported by a body of professional lawyers and judges. The court system is efficient. Although the Cayman Islands has not established its own accounting standards, there is a professional body of accountants and auditors which use US-GAAP or IAS (IFRS) for their audits. CIMA's supervision of other financial sectors and markets is generally efficient. There has been no evidence of government efforts to influence lending operations. Finally, there is no deposit insurance in the Cayman

Islands and CIMA can not act as lender of last resort, since CIMA's liabilities have to be covered for not less than 90 percent by foreign assets and since the CI dollar is pegged to the US dollar.

9. Although the two most important sectors of the Cayman economy—the hospitality industry as well as the financial sector—have suffered from the worldwide economical downturn, the economy of the Cayman Islands is in stable condition. The fiscal surplus is estimated at 4.6 percent of GDP in 2003. The outstanding debt of 130 million US dollar was paid off by issuing a bond with a maturity of 15 years, rated aa3, in order to reduce the interest rate and the administrative cost. The inflation rate is low at 2.4 percent.

Principle-by-principle assessment

10. ***Objectives, Autonomy, Powers, and Resources (CP 1)***—Besides its monetary functions, the principal function of CIMA is to regulate and supervise banking business carried on in or from within the Cayman Islands in accordance with the Monetary Authority Law (MAL) and the Banks and Trust Companies Law (BTCL). In performing its functions, CIMA is required to promote and maintain a sound financial system in the Cayman Islands. In this respect, CIMA is responsible for the authorization of banking establishments and their ongoing supervision. CIMA has the necessary powers to address compliance with laws, as well as safety and soundness concerns. CIMA is entitled to have access to books, records, and documents of any licensee and to request any information from any relevant person. CIMA is entitled to share supervisory information with other relevant supervisory authorities.

11. CIMA is operationally independent from the Governor.[1] The Governor, however, may, after consultation with the Board of Directors, give to CIMA general directions, when it is deemed necessary by him in the public interest. He also approves CIMA's budget. Furthermore, the members of the Board of Directors including the Managing Director of CIMA are appointed by the Governor; no CIMA director may be a member of Cabinet or the Legislative Assembly. Four of the directors are overseas directors and two of the directors are the managing directors of licensees but do not sit in meetings which would affect the business of these licensees. Although CIMA is staffed with qualified and experienced personnel who are granted regular training opportunities to enhance its supervisory functions, the BSD with over 300 banks under its jurisdiction and with only 26 positions seems to be understaffed. A 2003 salary survey indicated that salaries are comparable with the industry, except for a few posts. CIMA, its Directors, and its employees are provided with legal protection while discharging their duties in good faith, since none of these shall be liable in damages for anything done or omitted in the discharge or purported discharge of their respective functions, unless it is shown that the act or omission was in bad faith.

12. ***Licensing and Structure (CPs 2–5)***—The permissible activities of entities that are licensed and subject to supervision as banks are clearly defined. Only licensed banks may

[1] The term "Governor" refers to the "Governor in Cabinet" here and elsewhere in this report, except when the Governor, acting in his official personal capacity, assents or dissents to legislation.

receive deposits from the public and use the word "bank" or any derivatives in the description or the title under which the are carrying on the banking business. The Banks and Trust Companies (License Application and Fees) Regulation (BTCLAF), issued by the Governor under the BTCL, establishes the information an applicant has to provide and the criteria for licensing banks. The licensing process consists of an assessment of the banking organization's ownership structure, the fitness and propriety of the directors and senior management, its operating plan and internal controls, and its projected financial condition. CIMA may not grant a license unless the necessary information to assess the compliance with the licensing criteria are provided and the licensing criteria are fulfilled.

13. Generally, CIMA grants licenses only to branches and subsidiaries of banks that are licensed in a country or territory outside the Cayman Islands. In this respect, CIMA assesses whether the home supervisor in accordance with internationally recognized standards conducts consolidated supervision. It will not grant a license unless it receives confirmation from the home supervisor that there is no objection to the establishment of an office in the Cayman Islands, that there are no regulatory concerns with respect to the parent entity or the integrity and competence of the management, to the overall financial soundness of the bank, and that the branch or subsidiary will be included in the consolidated supervision of the parent entity.

14. Without CIMA's prior approval no shares in a bank may be issued and no issued shares may be transferred. Whenever CIMA is of the opinion that a person acquiring control or ownership of a bank is not fit and proper to have such control or ownership, it may take the necessary corrective actions. A locally incorporated bank may not open, outside the Cayman Islands, a subsidiary, a branch, an agency, or a representative office without the prior approval of CIMA. The acquisition of a stake in any another entity is regarded as a change to the business plan of the bank and needs the prior approval of CIMA.

15. ***Prudential Regulations and Requirements (CPs 6–15)***—Banks operate within a well-defined prudential regulatory framework, generally in accordance with Basel standards, that is largely modeled after the framework currently in use in the United Kingdom. The two-tiered required minimum risk capital standards are significantly above those required by the Basel Capital Accord and are applied in practice based primarily on the perceived differences in risk related to bank ownership.

16. Pursuant to its authority under the law, CIMA is putting in place rules and detailed guidance to set out its standards for the management of virtually all of the primary risks within which the banks in this market operate; the rules and guidance await only the final approval of the Governor. Guidance has been developed for credit risk, provisioning, large exposures and connected lending, foreign exchange risk, interest rate risk, liquidity risk, and operational risk. Guidance on investment risk and country/transfer risk is still to be developed. This guidance articulates the requirements for identifying, measuring, monitoring, and controlling each of these risks. The standards in all these guidelines are already used in practice based on CIMA's previously-issued policies and/or its complementary off-site surveillance and on-site inspection processes.

17. Pursuant to its authority under the law, CIMA is putting in place rules and detailed guidance to set out its standards for the management of internal control systems and internal audit programs, including required policies and procedures, as well as separate guidance for the implementation and operation of the corporate governance activities of the banks; the rules and guidance await only the final approval of the Governor. The standards in these guidelines are already used in practice based on CIMA's previously-articulated policies and its complementary off-site surveillance and on-site inspection processes.

18. Comprehensive guidance on anti-money laundering, which sets out the detailed requirements for implementing the requirements of the anti-money laundering laws and regulations, has been issued to the banks. Implementation of the requirements of the law, the regulations, and the guidance is being monitored in practice through CIMA's off-site surveillance and on-site inspection processes.

19. ***Methods of Ongoing Supervision (CPs16–20)***—The Banking Supervision Division of CIMA operates a comprehensive and effective risk-based supervision program, consisting of continuous off-site surveillance, periodic on-site inspection, and ongoing communications with the jurisdiction's licensees and, where applicable, their home country supervisory authority. Detailed supervisory polices and procedures have been developed and implemented for both the off-site and on-site processes. The diverse nature of the licensee population requires independent assessment of each licensee to determine the necessary risk-based scope of supervision. CIMA supervises the banking groups for which it is responsible on a consolidated basis.

20. The law permits CIMA to have unrestricted access to the licensees' business activities and records, facilitating both the off-site and on-site processes. A comprehensive regulatory reporting program has been put in place. Quarterly monitoring reports are produced by CIMA analysts. CIMA conducts annual inspections of retail banks and banks where it is the home country supervisory authority; inspections of other licensees with a physical presence in the jurisdiction are conducted every two years. CIMA also conducts overseas inspections of branches and subsidiaries. Contact with licensee management is maintained through both the off-site and on-site activities.

21. ***Information Requirements (CP 21)***—CIMA, in general, and the accounting profession require the use of international accounting, auditing, and reporting practices and standards. Exceptions are known to and understood by CIMA. Comprehensive regulatory reporting requirements are in place and reporting is regularly provided to CIMA. Audited financial statements are provided to CIMA annually, prepared by auditors approved by it. Meetings are held with the licensee's external auditor during each on-site inspection. CIMA is authorized to use auditors to conduct special audits and other investigations on its behalf. An amendment to the banking law is being drafted that would place on the external auditor the obligation to report to CIMA on solvency, non-compliance with laws, and other significant matters that the auditor becomes aware of during the audit. Relations and cooperation between CIMA and the audit industry are effective.

22. ***Formal Powers of Supervisors (CP 22)***—Whenever CIMA is of the opinion, for example, that a bank is or appears likely to become unable to meet its obligation as they fall due; that a bank has contravened the BTCL; or that a person holding a position as a director, manager or officer of a bank's business is not a fit and proper person to hold the respective position; it may revoke the license; require the substitution of any director or officer of the bank; appoint a person to advise the bank on proper conduct of its affairs; appoint a person to assume control of the bank's affairs; or require any action to be taken by the bank as it considers necessary. CIMA has issued guidelines on the ladder of compliance to clarify the procedures that it will follow in case of non-compliance by a bank.

23. CIMA has only limited powers to hold managers and directors personally liable, since rules issued by CIMA under the MAL may only provide for the imposition of penalties on banks and/or on the management for breach of such rules up to C$1,000. Moreover, CIMA's ability to arrange a take-over by or a merger of a failing bank with a healthier institution is somewhat hampered by the fact that customers may file liquidation proceedings at the Court without CIMA's consent.

24. ***Cross-Border Banking (CPs 23–25)***—Although there is no explicit provision in the BTCL that gives CIMA the objective to supervise banks on a consolidated basis, CIMA requires banks to prepare all relevant supervisory reports on a globally consolidated basis. Without the prior approval of CIMA, no locally incorporated bank shall open, outside the Cayman Islands, a subsidiary, branch, agency, or representative office. In the process of approval, CIMA assesses whether management is maintaining proper oversight of the bank's foreign branches, joint ventures, and subsidiaries, and whether the local management of any overseas offices has the necessary expertise to manage those operations in a safe and sound manner.

25. One of the principal functions of CIMA under the MAL is to provide assistance to overseas regulatory authorities. Therefore, CIMA may in the case of a routine regulatory request disclose to the overseas authorities requested information. In the case of a non-routine regulatory request, CIMA has to notify the Attorney-General as well as the Financial Secretary before disclosing the requested information. The MAL allows CIMA to enter into MOUs for the purpose of assisting consolidated supervision by the foreign supervisor.

26. Subsidiaries of foreign banks are subject to the same prudential and regulatory reporting requirements as domestic banks. Although branches of foreign banks are subject to the same regulatory reporting requirements as locally incorporated banks, they are not subject to the same prudential requirements. The large exposure limit of branches is based on their head offices' capital and the Rules for Large Exposures do not apply to them. CIMA, however, requires and verifies that they follow their head offices' large exposure limits, which are expected to be similar to CIMA's. Since branches do not have to have a donation capital, CIMA does not calculate any capital adequacy ratios for them. Based on its risk assessment, CIMA schedules routine on-site inspections of the local offices of subsidiaries and branches of foreign banks at least every second or third year. As part of its on-going supervisory process, CIMA's inspectors meet with home country regulators. CIMA also facilitates visits of foreign regulators to the Cayman Islands and routinely

conducts joint inspections of banks for the purpose of consolidated supervision. Inspections of all other entities are prioritized based on CIMA's risk assessment of the bank.

Table 1.1 Detailed Assessment of Compliance of the Basel Core Principles

Principle 1.	**Objectives, Autonomy, Powers, and Resources** An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	The Cayman Islands Monetary Authority (CIMA) is the only regulatory authority for banks operating in the Cayman Islands. The responsibilities, objectives and functions of the CIMA are set out in the Monetary Authority Law (MAL). Besides the monetary functions, the principal function of CIMA is to regulate and supervise financial services business carried on in or from within the Cayman Islands in accordance with the MAL and the Banks and Trust Companies Law (BTCL) and to perform any other regulatory or supervisory duties that may be imposed on CIMA by any other law, e.g., the Building Societies Law or the Cooperative Societies Law. In addition to this, CIMA has to provide assistance to overseas regulatory authorities in accordance with the MAL and to advise the Government on these matters. In performing its functions and managing its affairs, CIMA is required to act in the best economic interests of the Cayman Islands as well as promote and maintain a sound financial system in the Cayman Islands. CIMA also is required to endeavor to promote and enhance market confidence, consumer protection and the reputation of the Cayman Islands as a financial center. The Governor of the Cayman Islands may appoint an independent person to review CIMA's performance of any of its functions. The appointed person has to make a written report to the Financial Secretary setting out the result of the review and making recommendations. This report has to be laid before the Legislative Assembly. CIMA publishes an annual report in which it describes the overall stability of the financial sector. The BTCL sets out CIMA's role for supervising the banking industry. The BTCL establishes minimum prudential standards that banks must meet which include licensing requirements, change of ownership and control, approval of appointment of directors, and capital adequacy. The BTCL has been supplemented by the Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision) and several Statements of Guidance that address supervisory issues like the management of various risks and large exposures. Major supervisory actions rest with the Board of Directors and are taken based upon recommendation of the Management Committee of CIMA. With respect to problem banks, CIMA can take certain actions such as license revocation, restriction on activities, changes in management, and assume temporary management. It may assist in restructuring or merging the bank with a stronger institution. The BTCL has been amended, whenever there was the need to provide CIMA with the necessary powers to control the banking sector sufficiently.
Assessment	Compliant.
Comments	None.
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	In March 2003, CIMA was granted operational independence. The powers that were previously vested with the Governor are now reserved for the Board of Directors and/or the Management Committee of CIMA. The BTCL amendments in 2002 and 2003 increased CIMA's regulatory powers in relation to issues such as the approval for the granting of licenses, change in ownership of licensees, imposing conditions and restricting the activities of licensees and revocation of a banking or trust license. The Governor may after consultation with the Board of Directors give to CIMA general directions, when it is deemed necessary to him in the public

	interest. CIMA may issue Rules or Statements of Guidance only after consultation with the industry and with the approval of the Governor. The members of the Board of Directors including the Managing Director of CIMA are appointed by the Governor; no CIMA director may be a member of Cabinet or the Legislative Assembly. Four of the directors are overseas directors and two of the directors are the managing directors of licensees but do not sit in meetings which would affect the business of these licensees. The Managing Director is an employee of CIMA on such terms and conditions of service as the Governor, after consultation with the Board of Directors, may decide. The contracts of the members of the Board of Directors with the exception for the Managing Director are limited to three years. The contract of the Managing Director is written without an expiration date. The appointment of the Managing Director may be terminated by the Governor on the recommendation of the Board of Directors. The Governor may terminate the appointment of any director who for example becomes of unsound mind or incapable of carrying out his duties, becomes bankrupt, is convicted of an offence involving fraud, or is guilty of serious misconduct in relation to his duties. The Governor may also terminate the appointment of any director in the public interest. The Governor is not required to disclose publicly the reasons for the termination of the appointment of any director. CIMA is staffed with qualified and experienced personnel who are granted regular training opportunities to enhance the supervisory functions of CIMA. All staff is subject to a structured banking supervisory training program, utilizing courses offered by regional central banks, the Federal Reserve System in the United States, the Office of the Comptroller of the Currency, the Financial Stability Institute, the Toronto Center, and the Bank for International Settlements. Representatives of various banks confirmed, that CIMA's staff has a thorough understanding of the banks' business and that on-site inspections were well planned and conducted. A 2003 salary survey indicated that salaries at CIMÀ are comparable with the industry, except for a few posts. CIMA continues its recruitment efforts to attract qualified and experienced staff. In an effort to remain competitive with the private sector and to attract persons with the right expertise, CIMA's pay scale is independent from that of the Government and as such allows for more flexibility to negotiate remuneration packages. However, in the Banking Supervision Division (BSD) of CIMA there are five vacancies. Therefore, with over 300 banks under its jurisdiction and with only 26 positions in the BSD of CIMA the banking supervisory function seems to be understaffed. The BSD, however, is supported by the Compliance Division, the Legal Division and the Policy and Research Division. CIMA may also commission external auditors for focused inspections. The budget of CIMA (C$8,400,000) is set up by CIMA, but approved by the Governor; however, this appears to be only a formal procedure. The budget reflects the different functions and objectives of CIMA (on-site inspections, off-site analysis, training, etc.) and is established by a bottom-up approach.
Assessment	Largely Compliant.
Comments	CIMA's independence is constrained by the requirement that the Governor must approve the issuance of prudential rules and statements of principles and guidance. Staff shortages could impact CIMA's ability to adequately conduct its supervision program.
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	According to the BTCL, no banking business may be transacted without a valid license of CIMA. The application is to be made to CIMA accompanied by the information prescribed by CIMA in its Banks and Trust Companies (License Application and Fees) Regulation. CIMA may make inspections with respect to applications for licenses. Whenever CIMA is of the opinion that a bank has failed to comply with the conditions of the license or has contravened the BTCL, it may revoke the license. CIMA is entitled to issue or amend Rules or Statements of Principle or Guidance concerning the

	conduct of banks and their officers and employees. CIMA, however, has to consult the private sector and to seek the approval of the Governor. It has to inform the Governor which suggestions of the private sector it has not taken into account. The Rules or Statements of Principle or Guidance, of course, have to be consistent with the BTCL and any other regulatory law or regulations or directions. In performing its supervisory functions, CIMA has access to the books and records of any bank and may request any information in the form and frequency it deems necessary. Under the MAL, CIMA may at all reasonable times require a person regulated under the BTCL, a connected person, or any person reasonably believed to have information relevant to an enquiry by CIMA, to provide specified information or information of a specified description as it may reasonably require in connection with the exercise of CIMA's regulatory functions. CIMA receives audited annual accounts and on a quarterly basis a balance sheet, a statement of income and expense, information on the ten largest loans and depositors, information on large exposures, information on past due loans, and on interest rate sensitivity.
Assessment	Compliant.
Comments	None.
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.
Description	The BTCL and the MAL give CIMA all the necessary legal authority to ensure compliance with laws. The BTCL gives CIMA the necessary discretion to apply qualitative judgment and to react to breaches with the legal requirements on an individual basis. CIMA may also authorize any other person to assist it in the performance of its functions under the BTCL. In performing its supervisory function, CIMA is entitled to have access to books, records, and documents of any licensee and to request any information from any person as it may reasonably require in connection with the exercise of its function. Whenever CIMA is of the opinion that a bank is carrying on business in a manner detrimental to the interest of its depositors or other creditors, has contravened the BTCL, or has failed to comply with a condition of its license, CIMA is empowered to require action to be taken by that bank CIMA considers necessary for compliance with the law or the bank's license, to require the substitution of the any director or officer of the bank, or to revoke the license.
Assessment	Compliant.
Comments	For additional comment, see CP 22.
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	The BTCL, as well as the MAL, provides CIMA, its Directors, and its employees with legal protection while discharging their duties in good faith, since none of these may be liable in damages for anything done or omitted in the discharge or purported discharge of their respective functions under the BTCL or the MAL, unless it is shown that the act or omission was in bad faith. Although, there is no provision that protects CIMA and its staff against the costs of defending their actions while discharging their duties, neither CIMA nor its staff have to carry the costs of defending when the courts dismisses the action against them. In addition, the in-house lawyers could provide legal advice and act in the court proceeding on behalf of CIMA and its staff.
Assessment	Compliant.
Comments	CIMA should consider issuing a statement that it will provide its staff legal advice and funds to cover the costs of defending actions while discharging their duties.
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	According to the MAL, CIMA has to provide assistance to overseas regulatory authorities. In this respect, it may disclose information relating to the affairs of a licensee that it has acquired in the course of its duties or in the exercise of its functions to an overseas regulatory authority. When the request of the overseas regulatory authority is not a routine regulatory request, i.e., a request that goes beyond the purpose of allowing the overseas regulatory authority to carry out its day to day functions of approval of licenses, approval of persons subject to regulation, and registration of applicants, it has to inform the Attorney-General and the Financial Secretary. The

	Attorney-General may take part in any proceedings arising from any such request. CIMA, however, may not disclose any information unless it has satisfied itself that the recipient authority is subject to adequate legal restrictions on further disclosure, unless the recipient authority has assured that it will not disclose the information without the CIMA's consent, and unless the requested information is necessary for the overseas authority's regulatory functions. With the approval of the Governor, CIMA may enter into MoUs with overseas regulatory authorities for the purpose of assisting consolidated supervision by such authorities. CIMA has to notify the Financial Secretary of each MoU and to publish it. CIMA has signed MoUs with Brazil and Jamaica and is negotiating others with the Isle of Man and Panama. It has active working relationships with other supervisory agencies. CIMA may authorize overseas regulatory authorities to conduct on-site inspections in the Cayman Islands. The overseas authorities have to sign a confidentiality agreement. CIMA decides on a case-by-case basis whether it wants to join the foreign supervisor in the inspection.
Assessment	Compliant.
Comments	For additional comments, see CPs 23 to 25.
Principle 2.	**Permissible Activities** The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
Description	According to the BTCL, the term "bank" is defined as a person carrying on banking business, which means the business of receiving (other than from a bank or trust company) and holding on current, savings, deposit, or other similar account money that is repayable by check or order and may be invested by way of advances to customers or otherwise. Only licensed banks may in any manner whatsoever solicit or receive deposits from the public. Building societies and credit unions, which fall under CIMA's jurisdiction, may also receive deposits from their members. The permissible activities of institutions that are licensed and subject to supervision as banks are defined by their license. Therefore, any change in the operations of a bank needs the approval of CIMA. Licenses may be granted either for carrying on of banking business within and outside the Cayman Islands ("A" license) or with the restriction that the bank may not take deposits from any person resident in the Cayman Islands other than from another bank and invest in any asset which represents a claim on any person resident in the Cayman Islands except, for example, for transactions with another bank or the purchase of securities issued by the government ("B" license). Holders of a "B" license which are subsidiaries or branches of banks licensed in a country or territory outside the Cayman Islands may carry on business in the Cayman Islands without a physical presence in the Cayman Islands. CIMA ensures, however, that these subsidiaries and branches are properly managed and controlled by their respective head office. CIMA may impose the restriction to the "B" license that the holder of the license may not receive or solicit funds by way of trade or business from persons other than those listed in any undertaking accompanying the application for the license (Restricted "B" license). Except with the CIMA's approval only licensed banks may use the word "bank" or any derivatives in the description or the title under which it is carrying on the business from within the Cayman Islands. CIMA is entitled to request any information, matter, or thing from any person who it has reasonable grounds to believe is carrying on banking business in the Cayman Islands without a license as it may reasonably require for the purpose of enabling it to perform its licensing function. Whoever conducts banking business without a license is guilty of an offence and is liable on summary conviction to a fine of C$10,000 and to imprisonment for one year, and in the case of a continuing offence to a fine of C$1,000 for each day during which the offence continues.
Assessment	Compliant.
Comments	None.

Principle 3.	**Licensing Criteria** The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Description	The Banks and Trust Companies (License Application and Fees) Regulation (BTCLAF), issued by the Governor under the BTCL, establishes the information an applicant has to provide and the criteria for licensing banks. Every application should be in writing and must be sent to CIMA accompanied by such information and particulars and details as prescribed in the BTCLAF. CIMA may not grant a license unless the necessary information to assess the compliance with the licensing criteria is provided and the licensing criteria are fulfilled. CIMA may revoke the license, if a bank fails to comply with the conditions of its license. With regard to the shareholders of a bank, the application has to include: • the name of each shareholder, who holds more than 10 percent of the applicant's issued share capital or voting rights; • the annual accounts, for the two previous years together with the accounts of the parent undertaking of the shareholder, if any; • three references (two character references, one financial reference from a bank); • a personal questionnaire on, for example, education, employment, or interests in other financial institutions; • police clearance certificate. Apart from locally owned banks, CIMA currently grants licenses only to branches and subsidiaries of banks that are licensed in a country or territory outside the Cayman Islands. In this respect, CIMA assesses whether consolidated supervision is conducted by the home supervisor in accordance with internationally recognized standards. It will not grant a license to a branch or subsidiary unless it receives confirmation from the home supervisor that there is no objection to the establishment of an office in the Cayman Islands, that there are no regulatory concerns with respect to the parent entity or the integrity and competence of the management, to the overall financial soundness of the bank, and that the branch or subsidiary will be included in the consolidated supervision of the parent entity. This restrictive licensing policy lightens the responsibility for the determination of the suitability of major shareholders, of the transparency of ownership structure, and of the source of initial capital. With regard to the managers, directors and officers: • evidence of two effective directors, one of whom must possess a sound professional knowledge of and experience in the banking business commensurate with the intended activities of the bank (competence and capability); • three references (two character references regarding honesty, integrity and reputation, one financial reference from a bank regarding the financial soundness); • a personal questionnaire on, for example, education, employment, or interests in other financial institutions; • police clearance certificate. CIMA is required to refuse to grant a license if it is of the opinion that the business to which the application relates would not be carried on by persons who are fit and proper persons to be directors, managers, or officers. The fit and proper assessment is both an initial test undertaken during consideration of an application for licensing and a continuing test in relation to the conduct of the business. Therefore, CIMA may require the substitution of any director or officer of a bank, when the person holding a position as a director, manager or officer of a bank is not fit and proper to hold the respective position. A bank may at no time have less than two

	directors. Before the appointment of a director or other senior officer, a bank must apply to CIMA for the approval of such appointment. CIMA must refuse to grant approval if it is of the opinion that the designated director or other senior manager is not fit and proper. With regard to the objectives of the bank, the application must include: • details of the current business activities; • business aims; • a detailed statement setting out its proposed initial assets and its proposed assets and expected liabilities at the end of each of the two years next succeeding the date of such grant together with an estimate of expected income; • a copy of the most recent balance sheet; • particulars of the management structure and personnel; and • a statement as to its customer base. CIMA reviews the provided information to determine whether the strategic and operating plans, as well as the operational structure of the applicant, comply with CIMA's draft statements of guidance on corporate governance, internal audit, internal control, and operational risk management which reflect CIMA's current policy on these issues. A license will not be granted to a bank unless it has a net worth of not less than C$400,000 or such greater sum as may be determined by CIMA. The initial net worth, however, depends on the proposed business plan of the applicant. CIMA indicated that most newly established subsidiaries have an initial net worth of at least C$5,000,000. A bank must at all times maintain the net worth required by its license. CIMA assesses whether the proposed capital base of the applicant is sufficient to support the future growth of the entity according to its proposed strategic plan. CIMA may revoke the license of a bank, when in its opinion a bank has contravened the BTCL and BTCLAF. Any bank or any director or officer of a bank who knowingly or willfully supplies false or misleading information to CIMA is guilty of an offence and liable on summary conviction to a fine of C$10,000 and to imprisonment for one year.
Assessment	Largely Compliant.
Comments	Currently, applicants are not required to maintain their initial capital in cash. However, a proposed amendment to the BTCL will give CIMA the power to require a bank to maintain capital funds in cash in the Cayman Islands in such amounts and in such manner as CIMA considers necessary.
Principle 4.	**Ownership** Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	No shares in a bank may be issued, and no issued shares may be transferred or disposed of in any manner without the prior approval of CIMA. CIMA may exempt from this provision a bank whose shares are publicly traded on a stock exchange provided that the bank notifies CIMA of any change in control of the bank, the acquisition by any person or group of persons of shares representing more than 10 percent of the bank's issued share capital or total voting rights, or the acquisition by any person or group of persons of shares representing more than 10 percent of the issued share capital or total voting rights of the bank's parent company. The bank has to provide any information CIMA may require for the purpose of enabling an assessment as to whether persons acquiring control or ownership of the bank are fit and proper persons to have such control or ownership. The criteria for this assessment are the same as for the assessment of the suitability of shareholders in the process of licensing a bank. These provisions do not apply to the transfer or disposal of the legal interest only but also to the transfer or disposal of any beneficial interest in the shares. Since any change in shareholding is not valid until it has been approved by CIMA, the potential shareholder has no voting rights until he has gotten the required prior approval of CIMA.

	During on-site inspections, CIMA confirms the names and holdings of all shareholders, including the ultimate beneficial shareholders, of locally incorporated banks. Whenever CIMA is of the opinion that a person acquiring control or ownership of a bank is not fit and proper to have such control or ownership, it may take corrective actions.
Assessment	Compliant.
Comments	In other jurisdictions, the obligation to get prior approval from the regulator for the transfer of shares does not lie on the bank but on the potential acquirer of the interest. Therefore, it might be considered to entitle CIMA to issue administrative acts directly to the potential acquirer of the interest if he fails to provide sufficient information to assess his suitability or in a case that in the opinion of CIMA he is not suitable. In the case that the shareholder of bank is a legal person, CIMA should be informed about any change in the management of this entity and be provided with sufficient information to assess the suitability of the legal representative of this entity.
Principle 5.	**Investment Criteria** Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	A bank incorporated under the Companies Law may not open, outside the Cayman Islands, a subsidiary, a branch, an agency, or a representative office without the prior approval of CIMA. Since the acquisition of a stake in another entity is regarded as a change to the business plan of the bank, any such acquisition needs the prior approval of CIMA. In its assessment CIMA takes into account the business of the entity, the risk it may impose to the bank, the management of that entity, the jurisdiction in which that entity operates, and the financial and organizational resources of the bank to handle the acquisition. The law, however, does not define these criteria. In addition, investments in other entities fall under the definition of exposure for the purpose of the large exposure requirements and are therefore restricted to 25 percent of the capital base of a bank.
Assessment	Largely Compliant.
Comments	Neither the laws nor the regulations provide criteria by which to judge individual proposals for acquisitions and investments by banks. The new Rules, the new Statements of Guidance, and the existing Policies do not make any specific reference to investment policy, the making of investments, the ongoing management of investment portfolios, and investment risk management. CIMA should consider establishing Rules and a Statement of Guidance in this respect, which should also set out the criteria used by CIMA to review acquisitions and investments by banks. Revisions to the BTCL which have been drafted and sent out to industry for consultation seek to limit investments in the shares of any commercial entity and in real estate to 20 percent of a bank's net worth (i.e., excess assets over liabilities), unless otherwise approved by CIMA. It is expected that the consultation process and any amendments will be completed by the end of 2003.
Principle 6.	**Capital Adequacy** Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.
Description	Banks have to maintain a net worth, i.e., excess assets over liabilities as presented under applicable generally accepted accounting principles subject to adjustments for non-admitted assets as determined by CIMA, as required by its license. CIMA may require a bank to increase its net worth by increasing its paid-up capital to such greater sum as CIMA determines for the nature of the current or proposed business operations of a bank. CIMA may require such action to be taken by the bank as CIMA considers necessary, when CIMA is of the opinion that a bank is not complying with the BTCL and rules and regulations issued under the BTCL. All banks are required to submit quarterly financial statements, from which CIMA is able to compute the capital adequacy ratios of the locally incorporated banks.

	The capital base for the calculation of capital adequacy ratios is defined as: Tier 1 Capital Shareholders' equity issued and fully paid-up common stock + additional paid-up capital in excess of par or nominal value + unappropriated retained earnings +/- current year's net income or loss - treasury stock + minority interests, in the case of consolidated reports only - minus goodwill and other intangible assets + Tier 2 Capital (≤ 100 percent of Tier 1 Capital) unsecured subordinated debt (≤ 50 percent of Tier 1 Capital) + hybrid debt/equity instruments + general loan loss reserves (≤ 1.25 percent of risk weighted assets) - Deductions from Tier 1 and Tier 2 Capital investment in equity and subordinated debt instruments in subsidiaries and affiliates, that are not included in consolidated reports + securities owned in subsidiary and other affiliated entities engaged in banking or other financial business such as leasing; factoring; securities trading, brokering and underwriting; and insurance, in the case of consolidated reports only connected loans + locked-in connected lending (lending of a capital nature to a connected party) Minority interests are defined as claims by outside parties on the permanent shareholders' equity of any partly owned subsidiary or minority owned company, which is included in the consolidation. Unsecured subordinated debt with a minimum original fixed term to maturity of at least five years has to be subordinated in respect of both capital and interest to all other liabilities/debt of the bank. During the last five years to maturity of any debt issue, a discount factor of 20 percent per year is applied. Hybrid debt/equity instruments with a minimum original fixed term of maturity of at least five years have to be unsecured, subordinated and fully paid-up; are not redeemable at the opinion of the holder or without the prior consent of CIMA; are available to participate in losses without the bank being obliged to cease trading; and should allow for the deferment of debt service/payment obligations where the profitability or liquidity of the bank would not support payment. CIMA applies risk weightings of 0 percent, 10 percent, 20 percent, 50 percent, and 100 percent to the assets of bank. A 0 percent risk weighting is applied to cash, gold and silver bullion and loans and advances due from or guaranteed by Zone A central governments and central banks or monetary authorities. A 10 percent risk weighting is applied to treasury bills and other short term marketable paper, floating rate notes and fixed rate securities with a residual maturity of less than one year issued by Zone A central governments and central banks. A 20 percent risk weighting is applied to cash items in process of collection; to balances with and certificates of deposit issued by banks with a remaining maturity of less than 1 year; to marketable instruments issued by state or local governments and other non-commercial public sector institutions in Zone A countries with an original maturity of up to one year; to commercial paper and other short term negotiable securities issued by Zone A banks with an original maturity of up to one year; reverse repurchase agreements with other banks; loans and advances to state or local governments and other non-commercial public institutions in Zone A countries; loans and advances to banks in Zone A countries, Zone A central government and central bank securities with a residual maturity of one year and over; and, equity and debt securities issued by non-affiliated commercial banks in Zone A countries with an original maturity of over one year. A 50 percent risk weighting is applied to loans to individuals that are fully secured by a first property charge on residential property that is occupied by the borrower. All other assets have a risk weighting of 100 percent.

	Off-balance sheet items excluding derivatives are converted to on-balance sheet equivalents by multiplying the face or notional amounts by credit conversion factors. This product—the credit equivalent amount—is then assigned to the appropriate risk weight according to the on-balance sheet credit risk class determined by the obligator, counterparty, guarantor, or the nature of collateral held. A 0 percent conversion factor is applied to undrawn portions of credit commitments and contingencies with an original maturity of one year of less, or which are unconditionally cancellable at any time. A 20 percent credit conversion factor applies to short-term letters of credit. A 50 percent credit conversion factor applies to undrawn portions of commitments with an original maturity over one year; transaction-related contingencies and non-financial guarantees; and, note issuance and revolving underwriting facilities. A 100 percent credit conversion factor is applied to direct credit substitutes, standby letters of credit, repurchase agreements, and forward asset purchases. In practice, the capital adequacy ratios of all locally incorporated banks are computed and monitored by CIMA on a quarterly basis. Currently, all locally incorporated banks are required to maintain a minimum capital adequacy ratio of 12 percent for subsidiaries of banks that are licensed in a country or territory outside the Cayman Islands and 15 percent for privately owned banks.
Assessment	Compliant.
Comments	Although derivative contracts have to be reported by banks, they are not included in the calculation of the capital adequacy of banks. Furthermore, there are no capital requirements for market risk including foreign exchange and commodity risk. Since banks tend to take very little market risk in their books and rarely deal in derivatives and since foreign exchange risk is of minor relevance for banks' solvency, CIMA takes the stance that the required capital adequacy ratios of 12 percent and 15 percent, respectively, provide enough of a buffer to allow these risks not to be taken into account. Additionally, CIMA assesses during its on-site inspection the exposure of banks to market risk and to any risk inherent in their derivative activities. CIMA should monitor the developments in the banking sector closely in order to assess whether it has to specifically include market risk considerations in the capital adequacy ratio computations, once sophisticated business activities and products that generate significant market risk (e.g., derivatives) are in broader use. The proposed amendment to the BTCL will give CIMA the power to require a bank to maintain capital funds in cash in the Cayman Islands in such amounts and in such manner as CIMA considers necessary. Additionally, banks would not be permitted, at any time, to have a capital adequacy ratio of less than ten percent (or such percentage as may be determined by CIMA from time to time) as calculated in accordance with such form, content, and manner as may be determined by CIMA. CIMA may, if it considers it to be appropriate in the particular circumstances of a bank, having regard to the risks arising from the activities of the bank and over relevant factors, vary the capital adequacy ratio applicable to that bank. The amendments also clarify that a bank that fails to comply with the capital adequacy requirements may be treated by CIMA as carrying on business in a manner detrimental to the public interest and the interest of its depositors or other creditors, so that CIMA can apply all necessary remedial actions.
Principle 7.	**Credit Policies** An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
Description	CIMA has just issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision)* (the new Rules). CIMA finalized these rules in early October 2003. Section 3 (Credit Risk) of the new Rules requires that "a bank must adopt a sound system for managing credit risk" and requires that such a system "… must, at a minimum, (a) establish an appropriate credit risk environment; (b) operate a sound credit-granting process; (c) maintain an appropriate credit administration, measurement, and monitoring process; and, ensure adequate controls over credit risk." CIMA has also recently issued a Statement *of Guidance on Credit Risk Management* (the Statement of Guidance). The Statement of Guidance, restates, with only nominal alterations in format, CIMA's former *Policy*

	on Credit Risk Management (the existing Policy), which was issued in January 2003, and provides guidance on the requirements to be imposed by the new Rules. The new Statement of Guidance provides more-detailed guidance on the requirements for: establishing a credit risk environment; operating under a sound credit granting process; maintaining an appropriate credit administration, measurement, and monitoring process; and, ensuring adequate controls over credit risk. It incorporates by reference the *Principles for the Management of Credit Risk* and the *Best Practices for Credit Risk Disclosure* issued by the Basel Committee on Banking Supervision (the Basel Committee papers) as sources of further guidance. Where banks are subsidiaries of international banks, they are permitted to implement the credit risk management policies and procedures of their parent, modified, as necessary, in keeping with the requirements of CIMA. The new Rules and Statement of Guidance do not make any specific reference to investment policy, the making of investments, or the ongoing management of investment portfolios, and no separate Rule, Statement of Guidance, or Policy on investment risk management has been issued. The new Statement of Guidance requires that the board of directors "… review and approve, at least annually, the credit risk strategy and significant credit risk policies of the bank." It addresses the credit risk environment; the credit-granting process itself; credit administration, monitoring, and control; potential conflicts of interest and inappropriate external pressures; and the maintenance of adequate information systems providing essential details of the condition of the credit portfolio. The new Statement of Guidance does not directly address the necessary communication of credit assessment and standards to, at a minimum, those involved in the credit-granting process or the details and levels of the credit-approval processes; however, those matters are addressed and incorporated by reference through the Basel Committee papers. The BSD conducts ongoing off-site surveillance and periodic on-site inspections that include, inter alia, review, assessment, and verification of the implementation and operation of the requirements of the new Rules and new Statement of Guidance on credit risk. Off-site surveillance and on-site inspections also address investment risk—see CP 16 for further details. BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to monitor the risks that exist in the market. Section 34(8) of the MAL and Section 13(3)(a) of the) BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related to credit and investment risk management—see CP 18 for further details. Also, the BSD's quarterly collection of prudential and financial information, which, *inter alia,* includes information regarding on- and off-balance sheet exposures, provisioning, and large exposures, requires that the banks maintain systems to monitor the total indebtedness of those to which they extend credit. Information on investments is also collected.
Assessment	Largely Compliant.
Comments	CIMA should either amend the new Rules and Statement of Guidance or, preferably, develop a separate new Rule and new Statement of Guidance to specifically address all Investment Risk Management issues.
Principle 8.	**Loan Evaluation and Loan-Loss Provisioning** Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.
Description	CIMA has just issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision)* (the new Rules). CIMA finalized these rules in early October 2003. Section 6.1 of the new Rules requires that "a licensed bank must set out its policy on making loan loss provisions in a written statement." CIMA has also issued a new *Statement of Guidance on Loan Loss Provisions Allowances)* (the Statement of Guidance). The Statement of Guidance is intended to provide guidance on the requirement imposed on licensees by the new Rule, including ensuring that: banks have adequate loan loss provision policies and procedures to recognize, measure, and monitor loan impairment and that the board of directors

	and senior management are responsible for understanding and determining the nature and level of risk being taken by the bank and how these risks relate to the level of general and specific allowances. The Statement of Guidance addresses loan impairment (recognition and measurement), adequacy of the overall allowance, income recognition, and the responsibilities of the board of directors and management. Where banks are subsidiaries of international banks, they are permitted to implement the provisioning policies and procedures of their parent, modified, as necessary, in keeping with the requirements of CIMA. The Statement of Guidance requires that the board of directors approve the loan loss provisioning policies and procedures and be informed regularly on the loan loss provision and loan impairment. Management is responsible for: monitoring and managing loan quality; ensuring that loans are appropriately and reasonably valued; recognizing and providing for actual, expected, and probable losses; and maintaining effective systems and controls. The requirements cover both general and specific allowances, as well as actual write-off of recognized losses; large credits must be evaluated individually. They require a system for and periodic assessment of the strength of guarantees and the worth of collateral and set out the process for recognition of impairment and collectibility. While the guidance does not specifically address a formal loan "classification" process, the loan loss provisioning requirements would generate a determination of loan impairment and relative collectibility, as well as a process for dealing with recognized problem credits. Also, although the guidance does not specifically address "off-balance sheet" exposures, the definition of "loan" does include "other arrangements that are, in substance, loans." The process does include requirements for the formal recognition of delinquency, conversion of assets to non-accrual status, and loan restructuring. Neither the new Rules nor the new Statement of Guidance mandate specific provisioning requirements, since the diverse nature of the licensees requires that each independently determine appropriate provisioning levels based on their own asset structure. The BSD conducts ongoing off-site surveillance and periodic on-site inspections that already include, *inter alia*, review, assessment, and verification of the implementation and operation of the requirements that are included in the new Rules and the new Statement of Guidance—see CP 16 for further details. Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related to loan loss provisioning—see CP 18 for further details. Also, the BSD's quarterly collection of prudential and financial information includes, *inter alia,* information on general and specific provisioning, as well as delinquencies and non-accruals. Such reporting does not currently include data on classified assets. On-site inspections include a review of provisioning policies and their effective implementation, based on all of the requirements of the new Rules and the new Statement of Guidance. This includes, *inter alia*, the collection process and the realistic recognition of provisions and write-offs based on realistic repayment expectations. External auditors also evaluate provisioning policies and procedures during their annual audit of financial statements. Section 14(1)(vi) of the BTCL states that CIMA may "… require such action to be taken by the licensee as the Authority considers necessary." This provides CIMA with the authority to require that a bank strengthen its lending policies, credit-granting standards, level of provisions and reserves, and overall financial strength.
Assessment	Largely Compliant.
Comments	CIMA should modify the new *Statement of Guidance on Loan Loss Provision (Allowances)* to more specifically address the required inclusion of "off-balance sheet exposures" and include a "classifications" process in its requirements. Information on asset classifications should be periodically collected.

Principle 9.	**Large Exposure Limits** Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.
Description	The board of each bank must set out its large exposure policy, including exposures to individual customers, group related/associated persons, connected parties, banks, countries and economic sectors, in a policy statement. A group of closely related/associated counterparties means two or more natural and/or legal persons holding exposures from the bank or any of its subsidiaries, whether joint or separate basis, but who are mutually associated in that one of them holds directly or indirectly power of control over the other; their aggregated exposure represent to the bank a single risk in so much as they are so interconnected with the likelihood that if one of them experiences financial problems the other or all of them are likely to encounter repayment difficulty, for example, common ownership or common directors, cross guarantees, or direct commercial interdependencies that cannot be substituted in the short term. "Group" is defined as a company and any other company that is its holding company or subsidiary; a company and any other company which is a subsidiary of the holding company; a company and any company that directly or indirectly controls or is controlled by any aforementioned company; and a company and any company which is controlled by a person who directly or indirectly controls a aforementioned company. "Control" in this respect means the power of a person to secure by means of the holding of shares or the position of voting power or by virtue of any other agreement, that the affairs of a company are conducted in accordance with the wishes of that person. Banks must report all exposure in excess of 10 percent of its total capital base quarterly to CIMA on a solo and a consolidated basis. A bank must not incur an exposure to an individual borrower of group of closely related/associated counterparties that exceed 25 percent of its total capital base. Branches will not be permitted to have exposures that exceed 25 percent of the capital of their head offices. The total of all large exposures exceeding 10 percent of a bank's capital base must not exceed 450 percent of the bank's total capital base. Exposures of one year or less to banks in Zone A countries, securities firms (approved on a case-by-case basis) and multilateral development banks; exposures to, or guaranteed by, central governments and central banks or monetary authorities from Zone A countries; and exposure to Zone A (B?) central government if they are denominated in the respective country's national currency and funded by liabilities in the same currency are not included in calculating whether the aggregate of a bank's exposure to a particular counterparty is within the 25 percent limit. Exposure secured by cash including certificates of deposit issued by the bank held by the bank or back-to-back exposure may amount to up to but not exceed 100 percent of the bank's capital base, provided that both the exposure and the deposit are made in the same country and currency with the deposit hypothecating the exposure having the same or longer maturity. The hypothecating agreement must include a legally binding right to set-off between the deposit and the loan. A bank must notify CIMA immediately of any temporary breach of the 25 percent large exposure limits. In the case of subsidiaries subject to consolidated cross-border supervision, CIMA may permit exposures to exceed the 25 percent single exposure limit but not more than 50 percent of the Cayman bank's capital base, when the parent bank provides a suitable parental guarantee that covers the full amount of the exposure; the Cayman bank pre-notifies CIMA of the parental guarantee; the parent bank is supervised in accordance with the Basel Core Principles; CIMA receives written confirmation from the parent bank's supervisor that the exposure of the Cayman Bank is consolidated with the parent bank and does not breach any regulatory or statutory requirements in the parent bank's home country; and CIMA is of the opinion that the parent bank is a continuing source of financial strength for the Cayman bank and can at any time take over the exposure itself without exceeding its own large exposure limits.

	"Exposure" is defined as any claim on a counterparty including actual claims and potential claims which would arise from drawing down in full of undrawn facilities which a bank has committed itself to provide, and claims which a bank has committed to purchase or underwrite, for example, loans including overdrafts, leases, bills and received promissory notes, guarantees, irrevocable revolving lines of credit, investments like equities or bonds; contingent liabilities; assets and assets which a bank has committed itself to purchase or underwrite, the value of which depends wholly or mainly on a counterparty performing his obligations; derivative contracts including futures and forwards, options, swaps and similar contracts on interest rates, foreign currencies, equities, securities and commodities. Exposures to countries and economic sectors are not subject to CIMA's large exposure policy. However, banks are required to monitor concentration to a particular country, geographic region, and economic sector. Systems for measuring and monitoring such exposures need to be tailored to the size and complexity of individual bank's operations. CIMA may on a case-by-case basis require individual banks to meet limits for exposure to countries and economic sectors. In addition, banks have to report quarterly international claims and liabilities by country, instrument, and currency. Large exposures are monitored by CIMA through analysis of the quarterly financial statements filed by banks. The accuracy of the bank's financial statements is reviewed during on-site inspections; the inspections include a review of the large exposures reported to CIMA.
Assessment	Compliant.
Comments	This assessment is based on the new Rules recently issued by CIMA under the MAL and the related new *Statement of Guidance on Large Exposures* that is an explanatory note to those rules. Both the new Rules and the new Statement of Guidance reflect the current policy of CIMA on risk concentration. To ensure that CIMA may take corrective action pursuant to the BTCL, it might be considered establishing the principles of the large exposure regime in the BTCL.
Principle 10.	**Connected Lending** In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	The board of each bank must set out its large exposure policy, including exposures to individual customers, group related/associated persons, connected parties, banks, countries, and economic sectors, in a policy statement. The aggregate of all exposures to connected counterparties must not exceed 10 percent of the bank's total capital base. This limit, however, does not apply to connected counterparties engaged in banking activities, and subject to consolidated and cross-border supervision based on international standards. In these cases, exposures to connected counterparties are subject to the general 25 percent large exposure limit. Unsecured exposures to connected counterparties must not exceed 1 percent of the banks capital base. Locked-in connected lending, i.e., lending of a capital nature to a connected party, is to be deducted from the capital base. A connected counterparty is defined as a director, controlling shareholder, officer, or any other natural or legal person that is directly or indirectly affiliated to the bank, for example, any company which together with the bank constitute a group—see CP 10 for the definition of a group; an individual who is a director, manager, or a person who has control of the bank or any partner or immediate relative of such director, manager or person as aforesaid, and any company of which any of the persons referred to before is a director, manager, or has control. An immediate relative in respect to any person is defined as the spouse, children, parents, and siblings. All extensions of credit should be made on an arm's-length basis. In particular, credits to related companies and individuals (i.e., connected counterparties) should be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's-length lending. CIMA requires that banks have procedures in place to

	prevent persons benefiting from the loan being part of the preparation of the loan assessment or of the decision itself. Banks have to report quarterly to CIMA related party loans and advances due from group companies; due from directors, controllers and their associates; due from non-group counterparties with which directors and controllers are associated; and due from banks. In the reports on large exposure, banks have to point out those loans that are due from related parties. During its on-site inspections, CIMA reviews information on aggregate lending to connected and related parties.
Assessment	Largely Compliant.
Comments	CIMA does not require that transactions with connected or related parties exceeding specified amounts or otherwise posing special risks are subject to approval by the bank's board of directors. Banks are not required to monitor loans to connected parties through an independent credit administration process. This assessment is based on the new Rules recently issued by CIMA under the MAL and the new *Statement of Guidance on Large Exposures* that is an explanatory note to those rules. The new Rule and the new Statement of Guidance reflect the current policy of CIMA on risk concentration. To ensure that CIMA may take corrective action pursuant to the BTCL, it might be considered establishing the principles of the lending to connected counterparties in the BTCL. CIMA is considering re-drafting the Rules on Large Exposures and the related Statement of Guidance to provide for the discretion to vary the limits for exposure to connected parties that are engaged in banking activities and subject to consolidated and cross-border supervision on a individual basis.
Principle 11.	**Country Risk** Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
Description	CIMA has recently issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision)* (the new Rules). CIMA finalized these rules in early October 2003. Section 5.2, of the new Rules requires that the "… the board of each bank must set out its large exposures policy, including exposures to … countries … in a policy statement." The new Rules set out general large exposure limits, but not aggregate country risk exposure limitations, but do, in Section 5.4, create exceptions to the general limits related to certain exposures to banks, central governments, and central banks in a specific group of countries, as well as multilateral development banks. CIMA has also recently issued a new *Statement of Guidance on Large Exposures* (the Statement of Guidance). The new Statement of Guidance is intended to provide guidance on the obligations imposed on licensees by Section 5.2 of the new Rules. Specifically, Section 7 of the Statement of Guidance addresses the licensee's obligation to monitor concentrations in particular countries and geographic regions, using systems for monitoring and measuring such exposures tailored to the licensee's operations. Licensees themselves set their own country risk guidelines and limits. Where banks are subsidiaries of international banks, they are permitted to implement the country risk policies and procedures of their parent, modified, as necessary, in keeping with the requirements of CIMA. However, pursuant to Section 7.1 of the Statement of Guidance, CIMA may impose limitations on a licensee's country exposures. Section 3.3.5 of the new *Statement of Guidance on Loan Loss Provision (Allowances)* also includes country risk as a factor to be considered in the evaluation of credit quality. The issue of transfer risk is not addressed in the new Rules or in either new Statement of Guidance. CIMA has begun drafting a new Rule and a new Statement of Guidance that will deal specifically with country risk and transfer risk.

	The BSD conducts ongoing off-site surveillance and periodic on-site inspections that already include, *inter alia*, review, assessment, and verification of the implementation and operation of the requirements that are included in the new Rules and the new Statement of Guidance. (See CP-16, following, for further details.) BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to monitor the risks that exist in the market. Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related to the management of country risk—see CP 18 for further details. Also, the BSD's quarterly collection of prudential and financial information includes, *inter alia,* information on exposures to central governments and international claims by country, instrument, and currency. On-site inspections include a review of country risk policies and their effective implementation, based on all of the requirements of the new Rules and the new Statement of Guidance. There is not a separate section on country risk in CIMA's *Bank Supervision On-Site Inspection Manual*; however, country risk-related issues are included in the review of credit risk and loan loss provisioning. Inspections review country risk identification, monitoring, evaluation, and control policies and procedures, including information, risk management, and internal control systems. External auditors review country risk exposures during their annual audit of financial statements, and, when appropriate, may include information on such exposures, for both assets and liabilities, in the information accompanying the annual audited financial statements.
Assessment	Largely Compliant.
Comments	CIMA does not currently require that banks have adequate policies and procedures for identifying, monitoring, and controlling transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks. CIMA is currently drafting a new Statement of Guidance that will deal both with country risk and transfer risk. CIMA should complete the process to develop and implement a Rule and a Statement of Guidance specifically dealing with country risk and transfer risk; CIMA has already drafted a Rule and a Statement of Guidance on this topic. CIMA should develop more specific policies and procedures regarding on-site examination consideration of country risk and transfer risk.
Principle 12.	**Market Risks** Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.
Description	CIMA has recently issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision)*. CIMA finalized these rules in early October 2003. There are no proposed new Rules regarding foreign exchange risk or other market-related risks. However, CIMA has issued a new *Statement of Guidance on Foreign Exchange Risk Management* (the Statement of Guidance). The Statement of Guidance is intended to provide a standard of best practice for the implementation of an effective and sound foreign exchange risk management system. It addresses*, inter alia*: board and senior management oversight and responsibilities; strategy, monitoring, and control; establishing limitations; and dealing with contingencies. Banks are permitted to set their own foreign exchange risk-related limitations, as appropriate to their business, which are reviewed by CIMA during their ongoing supervisory process. Where banks are subsidiaries of international banks, they are permitted to implement the foreign exchange risk policies and procedures of their parent, modified, as necessary, in keeping with the requirements of CIMA. CIMA has the general authority to require licensees to increase their capital and, consequently, may impose a specific capital charge, pursuant to Section 8 of the BTCL, and/or to impose specific limits on any market risk exposure, pursuant to Section 14(1)(vi) of the BTCL. Also, an amendment to the BTCL has been drafted that would provide CIMA with the authority to require a licensee to maintain capital by specifically taking into account the risks arising from the licensee's activities. CIMA is of the view that its existing policy requiring risk capital ratios in excess of international standards provides coverage for any possible market risk—see CP 6.

	The Statement of Guidance provides for contingency planning and stress testing processes to measure vulnerabilities. Sophisticated modelling (e.g., VaR) is not mandated nor deemed necessary. Senior management of the BSD asserts that other than for hedging foreign exchange and interest rate risk the sophisticated business activities and products that generate significant market risk (e.g., derivatives) are not in general use in the current market. In the limited instances where such risk does exist, the BSD does include review of those activities in its supervision. Also, each licensee's external auditor would also review any such risk taking. CIMA requires that licensees receive its approval before engaging in new business activities. Their approval process for such changes includes*, inter alia*, determination of whether the new venture would produce market risk and whether the licensee had the expertise to understand and deal with such risk. The BSD conducts ongoing off-site surveillance and periodic on-site inspections that already include, *inter alia*, review, assessment, and verification of the implementation and operation of the requirements that are included in the new Statement of Guidance—see CP 16 for further details. BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to monitor the risks that exist in the market. Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related to the management of market risk—see CP 18 for further details. Also, the BSD's quarterly collection of prudential and financial information includes, *inter alia,* information on derivative instruments and foreign exchange contracts. On-site inspections include a review of market risk policies and procedures and their effective implementation, based on all of the requirements of the new Statement of Guidance. CIMA's *Bank Supervision On-Site Inspection Manual* includes broad coverage of market risk considerations and a more detailed section on foreign exchange risk. The inspections include, *inter alia*, review of policies and procedures for identifying, measuring, monitoring, and controlling risk and the management of the limitations process. The inspection verifies the implementation and quality of appropriate information, management, and control systems, and the adherence to limitations imposed. However, the inspection process does not include review of periodic stress testing and contingency planning; however, the sophisticated products that generate significant market risk do not currently exist in this market.
Assessment	Compliant.
Comments	CIMA should monitor the developments in the banking sector closely in order to assess whether it has to establish Rules and a Statement of Guidance for the industry on market risk, once sophisticated business activities and products that generate significant market risk (e.g., derivatives) are in broader use. The inspection procedures should include consideration of stress testing and contingency planning, where necessary.
Principle 13.	**Other Risks** Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.
Description	CIMA has recently issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision)* (the new Rules). CIMA finalized these rules in early October 2003. Section 4 (Interest Rate Risk) of the new Rules requires that banks have strategies and policies, approved by the board of directors, with respect to interest rate risk management and ensure that senior management monitor and control such risks. This section requires that such policies and procedures be defined and be commensurate with the licensee's activities and that operating limits and other practices to maintain exposures within limits must be established and enforced. Section 7 (Liquidity) of the new Rules requires that "… banks must maintain adequate liquidity taking into account the nature and scale of their business." This section requires that the limits set by the banks must ensure that they are able to meet their obligations as they fall due and provides that CIMA may impose limits on a case-by-case basis. There are no new Rules regarding operational risk or other material risks. CIMA has also issued a new *Statement of Guidance on Interest Rate Risk Management* (the IRR Statement of

	Guidance), a new *Statement of Guidance on Liquidity Risk Management* (the LR Statement of Guidance), and a new *Statement of Guidance on Operational Risk Management* (the OR Statement of Guidance) that restates, with only nominal changes in format, CIMA's former Guidelines on Operational Risk Management that were issued in January 2003. The IRR Statement of Guidance is intended to provide guidance on the obligations imposed on licensees by Section 4 of the new Rules. It addresses: board and senior management oversight; risk management policies and procedures; risk measurement and stress testing, monitoring, and control functions; and, internal controls. The IRR Statement of Guidance incorporates by reference the *Principles for the Management and Supervision of Interest Rate Risk* issued by the Basel Committee on Banking Supervision as a source of further guidance. The LR Statement of Guidance is intended to provide guidance on the obligations imposed on licensees by Section 7of the new Rules. It addresses: ongoing liquidity management, measuring and monitoring net funding requirements, managing market access, contingency planning, foreign currency liquidity management, and internal controls. The OR Statement of Guidance is intended to provide a standard of best practice for the implementation of an effective and sound operational risk management system. It addresses*, inter alia*: developing an appropriate risk management environment and risk identification, measurement, monitoring, and control. The new OR Statement of Guidance is based on Part 1 of *Sound Practices for the Management and Supervision of Operational Risk* issued by the Basel Committee on Banking Supervision, and incorporates Part 2, by reference, as a source of further guidance for large complex institutions. CIMA permits licensees to set their own limitations and policies and procedures, in keeping with the nature of their business activities and structure. These policies and procedures are reviewed by CIMA. Where banks are subsidiaries of international banks, they are permitted to implement the interest rate, liquidity, and operational risk policies and procedures of their parent, modified, as necessary, in keeping with the requirements of CIMA. CIMA reviews these policies and procedures to determine that they are appropriate for the institution and conform to its expectations for the licensee's effective management. The BSD conducts ongoing off-site surveillance and periodic on-site inspections that already include, *inter alia*, review, assessment, and verification of the implementation and operation of the requirements that are included in the new Rules and the new Statements of Guidance—see CP 16 for further details. BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to monitor the risks that exist in the market. Section 34(8) of the MAL and Section 13(3)(a) of the BCTL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related to the management of interest rate, liquidity, and operational risks—see CP 18 for further details. Also, the BSD's quarterly collection of prudential and financial information includes, *inter alia,* information on interest rate sensitivity and liquidity (e.g., large depositors, off-balance sheet assets and liabilities, and re-pricing maturities). On-site inspections include a review of interest-rate, liquidity, and operational risk policies and procedures and their effective implementation, based on all of the requirements of the new Rules and the new Statements of Guidance. CIMA's *Bank Supervision On-Site Inspection Manual* includes detailed sections on interest rate risk, liquidity risk, and operational risk. The inspections include, *inter alia*, review of management and board oversight responsibilities, policies and procedures for identifying, measuring, monitoring, and controlling risk, the abilities of the operating and administrative staffs, and the management of the limitations process. The inspection verifies the implementation and quality of appropriate information, management, and control systems, the appropriate communication of and delegation of responsibility for limits and procedures, and the adherence to limitations imposed. However, the inspection process does not include review of periodic stress testing and contingency planning; however, the sophisticated products that generate significant interest rate risk do not currently exist in this market.

	CIMA has the general authority to require licensees to increase their capital and, consequently, may impose a specific capital charge, pursuant to Section 8 of the BTCL, and/or to impose specific limits on any risk exposure, pursuant to Section 14(1)(vi) of the BTCL. Also, an amendment to the BTCL has been drafted that would provide CIMA with the authority to require a licensee to maintain capital by specifically taking into account the risks arising from the licensee's activities. CIMA currently believes that its existing policy requiring risk capital ratios in excess of international standards provides sufficient coverage for possible risks—see CP 6. Licensees are not generally required to provide public information on their risk management programs. However, because of the diverse nature of the ownership and structure of the licensees in the market, a few licensees are now required to provide information to the public.
Assessment	Compliant.
Comments	The inspection procedures should include consideration of stress testing and contingency planning, where necessary. Licensees that have shares that are publicly-trade and are required to provide public disclosure should include information on their risk management program in that disclosure.
Principle 14.	**Internal Control and Audit** Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.
Description	CIMA has recently issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision)* (the new Rules). CIMA finalized these rules in early October 2003. Section 1 (Internal Controls—General) of the new Rules requires that "… all licensees must take reasonable care to establish and maintain such systems and controls as are appropriate to their business. CIMA also recently issued a new Statement of Guidance on Internal Audit—Banks (the IA Statement of Guidance), a new Statement of Guidance on Internal Control in Banks (the IC Statement of Guidance), and a new Statement of Guidance on Corporate Governance (the CG Statement of Guidance). The IA Statement of Guidance is intended to provide guidance on the obligations imposed on licensees by Section 1 of the new Rules. It addresses the scope of the audit function; the permanence, independence, and impartiality of the function; the internal audit charter; the professional competence of audit staff; audit operations, procedures, and management; audit access to all activities and records; the audit committee of the board of directors; and the outsourcing of audit services. The IC Statement of Guidance is also intended to provide guidance on the obligations imposed on licensees by Section 1of the new Rules, as well as provide a standard of best practice for the implementation of an effective and sound internal control system. It addresses management and board responsibilities; control culture and oversight; risk recognition and assessment; control activities and segregation of duties; information and communication; and, monitoring activities and correcting deficiencies. The CG Statement of Guidance is intended "… to establish best practice guidelines for licensees with regard to corporate governance." It addresses the role, structure, and responsibilities of the board of directors; risk management, conflicts, and complaints; the audit function; and, regulatory relations. CIMA permits licensees to set their own policies and procedures, in keeping with the nature of their business activities and structure. These policies and procedures are reviewed by CIMA. Where banks are subsidiaries or branches of international banks, they are permitted to implement the internal control and internal audit policies and procedures of their parent, modified, as necessary, in keeping with the requirements of CIMA. CIMA reviews these policies and procedures to determine that they are appropriate for the business and organization of the institution and conform to its expectations for the licensee's effective management.

	CIMA expects all banks to have an internal audit function, based on its structure and the nature of its business, which reports its findings to the board or the audit committee. Many of the licensees are provided with internal control and/or internal audit services by the head and/or regional offices of their parent organizations. External auditors review the licensee's internal controls and internal audit activities during their annual audit. CIMA requires that all external audits be conducted by one of the four recognized international accounting firms. The Companies Law, which sets out the requirements for the organization and operation of the companies to which banking and trust licenses are granted, does not provide internal control, internal audit, and corporate governance principles to ensure effective control over risk management. Those principles are provided directly by CIMA through its Rules and Statements of Guidance. Directors and senior managers are held responsible under common law and criminal law for proper management of their organizations. CIMA requires the pre-approval of all directors and senior managers of licensees, pursuant to Section 12 of the BTCL, which allows the denial off approval if the candidate is not deemed fit and proper. CIMA may also revoke the approval of a director or senior manager. During this approval process, CIMA can and does evaluate the experience and skills of the proposed director or officer in relation to the licensee's structure and business and their potential contribution to the effective management of the institution. CIMA may require the substitution of a director or officer of a licensee that is deemed not to be fit and proper, pursuant to Section 14 of the BTCL. The BSD conducts ongoing off-site surveillance and periodic on-site inspections that already include, *inter alia*, review, assessment, and verification of the implementation and operation of the requirements that are included in the new Rules and the new Statements of Guidance. (See CP-16, following, for further details.) BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to conduct the surveillance and inspections. Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related to the management of internal controls, internal audit, corporate governance/risk management. (See CP-1(3), for further details.) Also, the BSD's quarterly collection of prudential and financial information provides the core for the BSD's comprehensive database on the licensee's activities. On-site inspections include a review of: internal controls, internal audit, and risk management systems, policies, and procedures, based on all of the requirements of the new Rules and the new Statements of Guidance. CIMA's Bank Supervision On-Site Inspection Manual includes detailed sections on internal controls, internal auditors, information systems, and compliance. The inspections include, *inter alia*, review of management and board oversight responsibilities; policies and procedures for identifying, measuring, monitoring, and controlling risk; the management of the limitations process; and, security programs. The inspection verifies the implementation and quality of appropriate information, management, and control systems, and the adherence to limitations imposed. It also assesses the involvement of the board of directors, the responsibilities of management, and the delegation of responsibilities within the organization.
Assessment	Compliant.
Comments	None.
Principle 15.	**Money Laundering** Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	Anti-money laundering requirements are primarily contained in the *Proceeds of Criminal Conduct Law (2001 Revision)* (the PCCL); the *Misuse of Drugs Law (2000 Revision)*; the *PCCL-Money Laundering Regulations (2003 Revision)*; the *PCCL-Money Laundering Amendment) Regulations, 2003*; the *PCCL-Money Laundering (Amendment) (Client*

	Identification) Regulations, 2001; and, the *PCCL-Money Laundering (Amendment)(No. 2) Regulations, 2002* (collectively, the laws and regulations). CIMA originally issued its *Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands* (the Guidance Notes) in April 2000. These laws and regulations are intended to provide a comprehensive system for the prevention and detection of money laundering. The BSD is responsible for ensuring that the banks have effectively implemented the requirements of and monitoring their compliance with the laws and regulations, pursuant to the PCCL-Money Laundering Regulations (2003 Revision) and the Guidance Notes. CIMA permits licensees to set their own policies and procedures, in keeping with the nature of their business activities and structure. These policies and procedures are reviewed by CIMA. Where banks are subsidiaries of international banks, they are permitted to implement the anti-money laundering policies and procedures of their parent, modified, as necessary, in keeping with the requirements of the laws and regulations and the Guidance Notes. The BSD conducts ongoing off-site surveillance and periodic on-site inspections of licensees that include, *inter alia*, review, assessment, and verification of the implementation and operation of the requirements of the laws and regulations—see CP 16 for further details. BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to conduct the surveillance and inspections. Such training includes sessions provided by banking, accounting, and legal associations, financial institutions, and foreign regulatory and supervisory authorities. Section 34(8) of the MAL and Section 13(3)(a) of the MAL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, facilitating the BSD's comprehensive review of all matters related the licensee's anti-money laundering programs—see CP 18 for further details. The BSD has begun to collect semi-annually information from licensees on their anti-money laundering programs as part of its regular reporting requirements. CIMA will collect information on non-compliant accounts. CIMA's *Bank Supervision On-Site Inspection Manual* includes a detailed section on anti-money laundering. The inspectors review the licensee's anti-money laundering policies and procedures to determine that they are appropriate for the institution and conform to the requirements of the laws and regulations and the Guidance Notes. The inspections include verification that appropriate monitoring, control, record-keeping, training, audit, and compliance policies, procedures, and systems are in place and operating effectively. They review the work of the internal auditor and the compliance officer, as well as discuss the licensee's anti-money laundering program with the external auditor. Consideration of the licensee's internal controls and management of operational risk would include efforts to identify and report other financial crimes to CIMA and to law enforcement authorities. The scope of the inspection of anti-money laundering activities would include: client identification processes, records requirements and retention periods, suspicious transactions recognition and reporting requirements, management responsibility (including the responsibilities of the money laundering reporting officer), and communications with and training of staff. Sections 22, 23, and 27 of the PCCL ensure that those who report suspicious transactions appropriately are not held liable. Section 14 of the BTCL provides CIMA with the authority to take action against a licensee that does not comply with its anti-money laundering obligations. Section 49 of the MAL provides CIMA the authority to appropriately share information on money-laundering activities with other supervisors and with relevant judicial authorities. The Guidance Notes provide for an effective compliance culture and the newly-issued Statement of Guidance on Corporate Governance provides that business should be conducted in a sound and prudent manner with integrity, due care, and professional skills. The laws and regulations embody recognized international sound practices, plus customer due diligence considerations. CIMA has the obligation to report suspicious transactions, pursuant to Sections 15 and 16 of the *PCCL-Money Laundering (Amendment) Regulations, 2003*, and does so through its own money laundering reporting officer, who also provides in-house specialist expertise on anti-money laundering, fraud, and other financial crimes.

Assessment	Compliant.
Comments	None.
Principle 16.	**On-Site and Off-Site Supervision** An effective banking supervisory system should consist of some form of both on-site and off-site supervision.
Description	CIMA, through its BSD, has developed and implemented a comprehensive and effective risk-based banking supervision system. This system is based on a mix of ongoing off-site surveillance and periodic on-site inspections, supplemented through regular, meaningful communication with the licensees, which produces an in-depth understanding of each licensee. The unique, diverse nature of the population of licensees requires that the BSD assess each individual licensee separately to determine the total scope of risk-based supervisory activity necessary to appropriately oversee it. BSD staff is provided with training designed to ensure that they have the actual level of expertise necessary to conduct the surveillance and inspections. Section 13 of the BTCL empowers CIMA to examine the business of a licensee as it sees fit either through requiring regular reporting or in such a manner as it thinks necessary. Section 13(4) Section 34(8) of the BTCL allows CIMA to authorize any other person to assist it in the performance of its functions (e.g., reporting accountants). Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, including internal and external audit reports, facilitating the BSD's comprehensive review of all matters related to the licensee. Section 10 of the BCTL requires the submission of annual audited financial statements of each locally-incorporated licensee and an audited annual report for the parent of each licensee not locally-incorporated. Also, the BSD's quarterly collection of prudential and financial information provides the core for the BSD's comprehensive database on the licensee's activities. Both off-site surveillance and on-site inspection are used to determine compliance with laws, regulations, rules, and statements of guidance. Section 49 of the MAL provides for the confidential treatment of information received as part of the supervisory process and provides for the disclosure of such information in certain defined circumstances. CIMA has developed and implemented a comprehensive *Off-Site Monitoring Manual* (the Off-Site Manual) to enable its on-going off-site surveillance program. The Off-Site Manual sets out the off-site monitoring objectives, responsibilities, and methodologies. Reports on off-site surveillance results are produced quarterly, using the prudential and financial reporting, the results on any on-site inspection or related follow-up, and communications with the licensee. These reports include an analysis of solvency, asset quality, profitability, liquidity, concentrations, interest rate sensitivity, investments, and other matters, as appropriate. Analyses are usually based on trends for the licensee through the previous five quarters. Because of the unique nature of the diverse population of licensees, trend analysis for the banking sector as a whole or for segments of the sector (e.g., peer analysis) is difficult and not particularly meaningful. The BSD produces a quarterly "watch list" on institutions about which there is concern, which is furnished to CIMA's board of directors. CIMA has developed and implemented a comprehensive *On-Site Inspection Manual* (the On-Site Manual) to enable its periodic on-site inspections. The On-Site Manual sets out the on-site objectives and methodologies for conducting and reporting on the results of on-site inspections. It includes inspection programs covering all areas of risk within the licensee, which are used as necessary to address the scope of each inspection. The scope of on-site inspections is determined based on the risk profile of the licensee through a pre-inspection planning and analysis process, using the results of off-site surveillance and previous on-site inspections to produce an inspection plan. On-site inspections are performed by the analysts responsible for the off-site surveillance of the licensee, under the supervision of BSD managers and other senior staff. On-site inspections are conducted annually on all retail banks and those banks for which CIMA is the home country supervisor. Inspections of other banks that have a physical presence are conducted every two years. Inspections of all other entities are prioritized based on CIMA's risk assessment of the bank. In addition to full scope inspections, CIMA has conducted a series of on-site visits to review operations of overseas branches and subsidiaries. Meetings

	with the licensee's external auditor are part of the on-site inspection process and, where appropriate, use the work of internal auditors to expedite the inspection. The on-site process provides, *inter alia*, for: the independent verification of corporate governance/risk management programs, determination of the reliability of information, and obtaining additional information about the licensee. The Cayman Islands Government's internal audit department conducts audits of the procedural aspects of the BSD's off-site function. A subcommittee of CIMA's board of directors is preparing to implement a new program to review the effectiveness of BSD's supervision program. This review will be conducted by three directors who have extensive banking supervisory/financial knowledge and experience.
Assessment	Compliant.
Comments	None.
Principle 17.	**Bank Management Contact** Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	The BSD of CIMA maintains regular contact with bank management through a program of prudential meetings with bank senior management. Prudential meetings are conducted at least annually with banks that carry on business in the domestic market and the privately-owned banks and at least every two years with the branches and locally-incorporated subsidiaries of international banks. These meetings are usually attended by bank senior management, but may also include members of the board, internal and/or external auditors, department heads, etc., as necessary based on the requirements of the meeting agenda. These regular meetings generally include discussions of bank performance, off-site surveillance or on-site inspection issues, corporate strategies, anti-money laundering, risk management, and other ongoing prudential matters. BSD also meets with parent and regional management, compliance staff, and internal auditors of international banks during their visits to the jurisdiction. Special meetings are called by CIMA to discuss significant risk or prudential concerns and such meetings may be with the entire board of directors of the licensee. Banks also request meetings to discuss proposed new business activities and changes in strategic or operating plans. Also, CIMA's new *Statement of Guidance on Corporate Governance* requires that the board appoint a liaison board member to deal with regulatory matters to ensure that the board is kept informed on any regulatory concerns or information and that the board should ensure that the appropriate follow-up action is taken following instructions or recommendations from CIMA. The BSD has gained a thorough understanding of each of the unique, diverse licensees under its jurisdiction. This understanding is based on ongoing off-site surveillance and periodic on-site inspections, regular and special prudential meetings, contact with home country supervisory authorities, and knowledge of home country financial systems. CIMA requires that licensees obtain their prior approval for any changes to their business activities or products. CIMA expects banks to notify them in a timely manner of any material adverse developments or adverse situations and the institutions do make such reports. Information is also obtained through the on-site inspection process through review of board minutes, review of complaints and legal issues, and the inspection procedures related to reputation risk. Consideration of management is a part of CIMA's ongoing supervisory process for each licensee, pursuant to its risk-based approach to supervision. Also, CIMA requires that all new directors and senior management, both during the licensing process and throughout the life of the institution, receive its prior approval before they assume their positions. The CIMA approval process includes a thorough fit and proper determination, including a determination of the candidate's specific experience and qualifications for the particular position proposed.
Assessment	Compliant.
Comments	None.

Principle 18.	**Off-Site Supervision** Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	Section 34(8) of the MAL and Section 13(3)(a) of BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, including internal and external audit reports, facilitating the BSD's comprehensive review of all matters related to the licensee. Annual audited information must be provided within 90 days after the period-end; quarterly returns must be submitted within 21 days of period-end. Section 10 of the BCTL requires the submission of annual audited financial statements of each locally incorporated licensee and an audited annual report for the parent of each licensee not locally incorporated. CIMA may also request special reporting from individual licensees or the entire population of licensees, as it deems necessary. BSD's quarterly collection of prudential and financial information provides the core for the BSD's comprehensive database on the licensee's activities. The standardized quarterly prudential and financial reporting provides information, on a solo and consolidated basis, for on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy (including reserves), liquidity, large exposures, loan loss provisioning and delinquencies, market risk, and deposit sources. The reporting does not include information on asset classification in regular reporting, although some licensees have been required to provide special reporting. CIMA, in general, and the local accounting profession require licensees to report using Generally Accepted Accounting Principles or International Accounting Standards (International Financial Reporting Standards). A few exceptions do exist where the licensee's home country regulators require a different regulatory reporting system. CIMA is aware of the aberrations that such reporting produces. CIMA has recently issued new *Rules for all Licensees Holding Banking Licenses under the Banks and Trust Companies Law (2003 Revision*) (the new Rules). Pursuant to Section 2 of the new Rules, financial institutions must submit their annual financial statements and prudential reports and statistical returns by the dates stipulated in the reporting guidance and/or the law. The new Rules also require the preparation of such reports in accordance with CIMA's instructions. CIMA's previous requirements, contained in its former *Policy on Prudential Reports and Statistical Returns,* issued in October 2002, mirror those that are contained in the new Rules. Section 34(7) of the MAL authorizes CIMA to impose monetary penalties for failure to comply with a rule. CIMA is now considering whether to establish monetary fines for late filing of returns. No fines are planned for mis-reporting, inaccuracies, or persistent errors. Senior management of the licensee is responsible for the accuracy of the returns, and is required to sign them. Section 34(8) of the MAL authorizes CIMA to request information on companies and individuals related to the licensee, relevant to the assessment of the financial condition of and the risks in the licensee. CIMA currently requires annual consolidated audit reports of all parent companies and may require information, as necessary, on other components of the parent organization. This information is used to provide for the ongoing assessment of the parent organization. Such information is not generally used for comparisons between banking organizations, since the diverse nature of the licensees and their parents make such comparisons of little value. There is no "holding company" supervision in the jurisdiction, as each financial services component is separately supervised by the separate divisions within CIMA that are then able to share information among themselves. BSD's off-site surveillance program uses the financial and prudential information provided by the licensee for the ongoing monitoring of its condition and performance. The results of this off-site monitoring are a factor in the planning of on-site inspections. CIMA has developed an automated information system to assist in data management and analysis. BSD analysts are responsible for maintaining the non-financial information obtained from licensees through communications and other means on the system.
Assessment	Largely Compliant.

Comments	CIMA should complete the process necessary to establish monetary fines for late regulatory reporting. It should also consider imposing fines for persistent inaccuracies in returns. CIMA should consider adding information on asset classifications to its quarterly prudential and financial reporting.
Principle 19.	**Validation of Supervisory Information** Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
Description	CIMA has in place a coherent process for planning and executing on-site inspections, using its own analysts/inspectors; it does also have the authority to use others (including external auditors) to assist it or to conduct special work at the licensees, pursuant to Section 13(4) of the BTCL. CIMA has developed and implemented a comprehensive *On-Site Inspection Manual* (the On-Site Manual) to enable its periodic on-site inspections. The On-Site Manual sets out the on-site objectives, responsibilities, and methodologies for conducting and reporting on the results of on-site inspections. It includes inspection programs covering all areas of risk within the licensee, which are used as necessary to address the scope of each inspection. The scope of on-site inspections is determined based on the risk profile of the licensee through a pre-inspection planning and analysis process, using the results of off-site surveillance and previous on-site inspections to produce an inspection plan. The on-site process provides, *inter alia*, for: the independent verification of corporate governance/risk management programs, determination of the reliability of information, and obtaining additional information about the licensee, as well as validating the information in supervisory returns. A meeting with bank management is conducted following the inspection to discuss its results and recommendations; depending on the issues involved the meeting may also involve the bank's directors. Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, including internal and external audit reports. Section 34(8) also authorizes CIMA to request information on companies and individuals related to the licensee, relevant to the assessment of the financial condition of and the risks in the licensee. Section 10 of the BCTL requires the submission of annual audited financial statements of each locally incorporated licensee and an audited consolidated annual report for the parent of each licensee that is not locally incorporated. CIMA may also request special reporting from individual licensees or the entire population of licenses, as it deems necessary. The jurisdiction has a well-qualified audit profession operating within it, primarily represented by the four international accounting firms. Section 10(1) of the BTCL requires that the auditor of each licensee be approved by CIMA; CIMA only approves audits by the four international firms for bank licensees. CIMA's *Policy on the Approval of and Auditor for a Regulated Institution*, issued in May 2002, sets out the criteria to be used in the assessment and the sanctions available for non-compliance. Meetings with the licensee's external auditor are part of the on-site inspection process and, where appropriate, inspectors use the work of internal auditors to expedite their inspection. CIMA also requires that each licensee provide it with a copy of their external auditor's management letter. CIMA may direct a licensee to engage an external auditor to conduct a special audit or provide other services for it; on occasion, CIMA contracts directly with the external auditor for such services. CIMA determines the scope of all such engagements and oversees their completion. CIMA meets periodically with the Cayman Islands Association of Professional Accountants to discuss issues of mutual interest. An amendment to the BTCL is being drafted that would place on the external auditor the additional obligation to report to CIMA certain specified information that the auditor becomes aware of during the audit. Such information relates to solvency, non-compliance with pertinent laws, carrying on business in a fraudulent manner, and other significant matters.
Assessment	Compliant.
Comments	CIMA should encourage the Legislative Assembly to enact the proposed BTCL amendments, once they are introduced.

Principle 20.	**Consolidated Supervision** An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	Section (6)(1)(b)(i) of the MAL states that one of the principal functions of CIMA is "… to regulate and supervise financial services business carried on in and from within the Islands…" There is no "bank holding company" regulation/supervision in the jurisdiction. However, sectoral divisions within CIMA regulate and supervise the individual components (e.g., banking, insurance, trust companies, etc.) of financial services groups that are headquartered in the jurisdiction, maintaining information and knowledge on each component. The non-financial activities of these companies are not formally included, but consolidated group financial information is analyzed. Although there is no formal process for the consolidation of supervisory results, the sectoral supervisors within CIMA work together on matters of shared interest and share information on the financial condition and risk management and controls for component companies. The BSD does regulate all of the banking components of these financial services companies on a consolidated basis. There is little non-banking business in the banks; what little that is there is included in the BSD's risk-based supervisory process. Section 13(1)(b) gives CIMA the authority the examine all of the affairs of and businesses of licensees, including those conducted through overseas branches or subsidiaries and affiliates. BSD has conducted on-site inspections of overseas branches and subsidiaries of licensees. Information on all subsidiaries and overseas branches is included in consolidated supervisory reporting. Financial and prudential information on licensees is obtained on a solo and consolidated basis. Information on affiliates of the bank may be obtained, pursuant to Section 34(8) of the MAL and Section 13(3)(a) of the BTCL. Section 11(a) of the BTCL states that CIMA's approval is required for a licensee to establish a foreign subsidiary, branch, agency, or representative office. CIMA also requires that licensees obtain their prior approval for any changes to their business activities or products or when proposing to add new business activities or products. The BTCL and CIMA's prudential standards, as set out in the new Rules and Statements of Guidance, are applicable on a consolidated basis. Consequently, there are no impediments to the direct or indirect supervision of all affiliates and subsidiaries of the banking organization. Generally, CIMA no longer licenses banks with non-financial corporate or individual ownership. However, previously licensed banks with such ownership structure are required to have physical presence in the Cayman Islands. Such licensees are subject to direct and indirect supervision and regulation, as detailed above. For such banks, a higher risk capital adequacy ratio (15 percent) is required and limitations have been placed on their business with their affiliates; further such restrictions are now being considered. Fit and proper determinations are made on the individual and corporate shareholders.
Assessment	Compliant.
Comments	None.
Principle 21.	**Accounting Standards** Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	Section 34(8) of the MAL and Section 13(3)(a) of the BTCL provide that CIMA may require the provision of any information that may be reasonably required in connection with its regulatory functions, including internal and external audit reports. Section 34(8) also authorizes CIMA to request information on companies and individuals related to the licensee, relevant to the assessment of the financial condition of and the risks in the licensee. The information must be provided on the reporting forms and according to the instructions imposed by CIMA. Such information must be provided within 90 days of period-end.

	Section 10 of the BCTL requires the submission of annual audited financial statements of each locally incorporated licensee and an audited consolidated annual report for the parent of each licensee not locally incorporated. Annual financial information provided to shareholders of the few publicly traded licensees in the jurisdiction is audited, but there is no requirement in the law or regulations for publication of this annual financial information. CIMA does not set the scope of regular annual external audits or the internal audits conducted by licensees, although both are reviewed and discussed during the on-site inspection. The on-site inspection process provides, *inter alia*, for the determination of the reliability of information and the validation of the information in supervisory returns. The annual audited financial statement is reconciled to the information provided on supervisory returns of the same quarter-end date. CIMA meets with the external auditors of licensees during the on-site inspections to discuss the audit scope and conclusions and the external auditors may be included at the periodic prudential meetings, with the consent of the licensee. Licensees furnish CIMA with their external auditor's management letter. Also, an amendment to the BTCL is being drafted that would place on the external auditor the additional obligation to report to CIMA certain specified information that the auditor becomes aware of during the audit. Such information relates to solvency, non-compliance with pertinent laws, carrying on business in a fraudulent manner, and other materially significant matters. This planned amendment to the BTCL would also give CIMA the specific authority to revoke the approval of an external auditor. Currently, such revocation may be done through CIMA's general authority over the bank in Section 14(1)(vi) of the BTCL. CIMA, in general, and the local accounting profession require licensees to report using Generally Accepted Accounting Principles or International Accounting Standards (International Financial Reporting Standards). A few exceptions do exist where licensee's home country regulators require a different regulatory reporting system. CIMA is aware of the aberrations that such reporting produces. Asset valuations and provisioning are made pursuant to these rules. Pursuant to Section 13 of the BTCL, CIMA may direct a licensee to engage an external auditor to conduct a special audit or provide other services for it; on occasion, CIMA contracts directly with the external auditor for such services. CIMA determines the scope of all such engagements and oversees their completion. Pursuant to its general authority in Section 14(1)(vi) of the BTCL, CIMA may require such action to be taken as it considers necessary, including the public issuance of individual bank financial statements. Section 49 of the MAL provides for the maintenance of confidentiality of information acquired in the course of CIMA's functions and provides for the circumstances when such information may be disclosed.
Assessment	Compliant.
Comments	CIMA should encourage the Legislative Assembly to enact the proposed BTCL amendments, once they are introduced.
Principle 22.	**Remedial Measures** Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.
Description	Under the BTCL, CIMA may, whenever it is of the opinion that a bank is or appears likely to become unable to meet its obligation as they fall due; a bank is carrying on business in a manner detrimental to the public interest, the interest of its depositors or of other creditors; a bank has contravened the BTCL; a bank has failed to comply with a condition of its license; the direction and management of a bank's business has not been conducted in a fit and proper manner;, a person holding a position as a director, manager or officer of a bank's business is not a fit and proper person to hold the respective position; or a person acquiring control or ownership of a bank is not a fit and proper person to have control or ownership, take several corrective actions. This includes the ability to revoke the license; to impose conditions, or

	further conditions, upon the license; to require the substitution of any director or officer of the bank; to appoint a person to advise the bank on proper conduct of its affairs; to appoint a person to assume control of the bank's affairs; or to require any action to be taken by the bank as CIMA considers necessary, for example, additional auditing of the level of provisions, restriction on dividends, restrictions on loans to related parties, the level of liquid assets. CIMA's ability to arrange a take-over by or a merger of a failing bank with a healthier institution is somewhat hampered by the fact that customers may file liquidation proceedings at the Court without CIMA's consent. CIMA has issued guidelines on the ladder of compliance to clarify the procedures that it will follow in the event of non-compliance by a bank. Typically CIMA will use a collaborative approach to remedial action where the bank's problems are minor. In considering what action to take in the event of a concern arising, CIMA will take into account the nature and extent of the contravention; the ability and extent to which remedial action will rectify the contravention; the willingness and ability of the bank to cooperate with and assist CIMA in terms of its investigations and recommendations; the compliance history of the bank; the extent to which the directors and officers have acted in a fit and proper manner; and, whether the number of issues indicate a pattern of unfit and improper behavior. CIMA will provide the bank with details of the contravention and request remedial action. The bank must notify CIMA of any remedial action taken. If that action is not effective, CIMA will make recommendations to the bank for corrective action within a prescribed period of time. In the event the bank does not comply with the recommendations for remedial action, CIMA will take appropriate action. When the matter is not satisfactorily rectified after CIMA's request for remedial action, it will place the bank on a watch list; require the Board of Directors of the bank to provide a letter of commitment, acknowledging CIMA's recommendations; may ask an external auditor to perform an audit or investigation in relation to the specific issue and to report to CIMA; and, increase the level the scope/frequency of on-site inspections and/or of reporting by the bank. In the event that the recommendations for remedial action are still not complied with, CIMA may issue specific directives and impose or expand existing business restrictions. In a final stage, CIMA's Compliance Division may apply the actions available under the BTCL. Rules issued by CIMA under the MAL may provide for the imposition of monetary penalties on banks and/or on the management for breach of such rules up to C$1,000. CIMA is considering including such provision of penalties in its reporting rule for a delay in reporting by the bank.
Assessment	Largely Compliant.
Comments	CIMA does not currently utilize its authority to impose monetary penalties, as provided in the MAL. The monetary penalties permitted in the MAL are minimal and provide little deterrence to violations. In order to ensure CIMA's ability to safeguard the interest of depositors, no liquidations proceedings should be filed without CIMA's consent
Principle 23.	**Globally Consolidated Supervision** Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.
Description	Although there is no explicit provision in the BTCL that gives CIMA the objective to supervise banks on a consolidated basis, CIMA requires banks to prepare all relevant supervisory reports on a consolidated basis. This requirement is based on the provision in the BTCL that CIMA examine, by way of receipt of regular returns or in any other manner that CIMA thinks necessary, the affairs or business of any bank carrying on business in or from with in the Cayman Islands for the purpose of satisfying itself that the banks comply with the BTCL and that they are in a sound financial position. In the case of subsidiaries, banks have to submit the audited annual accounts of that subsidiary to CIMA. Without the prior approval of CIMA, no bank may open, outside the Cayman Islands, a subsidiary, branch, agency, or representative office. In the process of approval, CIMA assesses whether management is maintaining proper oversight of the bank's foreign branches, joint ventures, and subsidiaries, and whether the local management of any overseas offices has the necessary expertise to manage those operations in a safe and sound manner. These issues are

	discussed in prudential meetings with the bank's management. CIMA also looks at reporting lines and the proposed business with respect to the expertise of both the bank's management and the overseas office's management. CIMA also assesses the quality of the foreign supervisor, the ability of the foreign supervisor to share relevant information with CIMA, and the legal framework of that jurisdiction. Once an overseas office has been established, CIMA extends its inspections of the bank to the overseas offices. Cayman banks have established branches and subsidiaries in Panama, Cyprus, and on the Isle of Man. CIMA may require the closing of overseas offices or restrict the business activities of these offices.
Assessment	Compliant.
Comments	None.
Principle 24.	**Host Country Supervision** A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
Description	One of the principal functions of CIMA under the MAL is to provide assistance to overseas regulatory authorities and it has a history of cooperating with overseas regulatory authorities. Therefore, CIMA may in the case of a routine regulatory request disclose to the overseas authorities requested information. In the case of a non-routine regulatory request, CIMA has to notify the Attorney-General as well as the Financial Secretary before disclosing the requested information. A routine regulatory request is defined as a request to provide information for the purpose of allowing the overseas authority to carry out its day-to-day functions of approval of licenses, approval of persons subject to regulation, and registration of applicants. In deciding whether or not to assist an overseas authority, CIMA must take into account whether corresponding assistance would be given to it by the relevant country or territory; whether the inquiries relate to the possible breach of a law or other requirements which has no close parallel in the Cayman Islands; the seriousness of the matter; the importance of the information to the inquiries; and whether in the light of the advice from the Attorney-General or Financial Secretary it is in the public interest to give the assistance. However, the Attorney-General has not advised CIMA not to disclose any information so far. Although the MAL allows CIMA to enter into MoUs only for the purpose of assisting consolidated supervision by the foreign supervisor, CIMA is in negotiations with those regulatory authorities in which jurisdiction Cayman banks have subsidiaries or branches. These MoUs will formalize the functioning working relationships with these authorities. CIMA has conducted overseas inspections and focused visits in Europe, in the United States, and in Central America. Without the prior approval of CIMA, no bank may open, outside the Cayman Islands, a subsidiary, branch, agency, or representative office. In the process of approval, CIMA assesses the quality of the foreign supervisor, the ability of the foreign supervisor to share relevant information with CIMA, and the legal framework of that jurisdiction.
Assessment	Largely Compliant.
Comments	Consideration is currently being given to amending the MAL to allow CIMA to enter into a MoU not only for the purpose of consolidated supervision by foreign supervisors, but also for any other purpose with the approval of the Governor and the Financial Secretary. The MAL should be amended to clarify that CIMA may provide unsolicited information to the host supervisor concerning the specific offices in the host country and concerning significant problems arising in the head office or in the group as a whole and may enter into MoU in cases where CIMA is responsible for the consolidated supervision of a banking group. Additionally, it is not in line with international best practices that the supervisory authority needs the approval of another authority to enter into MoUs with foreign authorities and, also, that in the case of a non-routine regulatory request it has to take into account the advice of another authority whether or not to disclose information to foreign authority. This may give room for political interference and weaken CIMA's independence.

Principle 25.	**Supervision Over Foreign Banks' Establishments** Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.
Description	Subsidiaries of foreign banks are subject to the same prudential and regulatory reporting requirements as domestic banks. Although branches of foreign banks are subject to the same licensing and regulatory reporting requirements as locally incorporated banks, they are not subject to the same prudential requirements. The large exposure limit of branches, for example, is based on their head offices' capital and CIMA's Rules for Large Exposures do not apply to them. CIMA, however, requires and verifies that they follow their head offices' large exposure limits, which are expected to be similar to CIMA's. Since branches do not have to have assigned capital, CIMA does not calculate any capital adequacy ratios for them. Based on its risk assessment, CIMA schedules routine on-site inspections of subsidiaries and branches of foreign banks at least every second or third year. For the purpose of the licensing process as well as ongoing supervision, CIMA acting as the host supervisor assesses whether consolidated supervision is conducted by the home supervisor in accordance with internationally-recognized standards. It will not grant a license to a branch or subsidiary unless it receives confirmation from the home supervisor that there is no objection to the establishment of an office in the Cayman Islands, that there are no regulatory concerns with respect to the parent entity or its management, and that the branch or subsidiary will be included in the consolidated supervision of the parent entity. Applicants have to submit to CIMA an organizational chart for the group to which they belong showing the parent entity, any subsidiaries or branches, any sister companies (affiliates), and the respective home country supervisor for each entity in the group structure. One of the principal functions of CIMA under the MAL is to provide assistance to overseas regulatory authorities. Therefore, CIMA may in the case of a routine regulatory request disclose to the overseas authorities requested information. In the case of a non-routine regulatory request, CIMA has to notify the Attorney-General as well as the Financial Secretary before disclosing the requested information. A routine regulatory request is defined as a request to provide information for the purpose of allowing the overseas authority to carry out its day- to-day functions of approval of licenses, approval of persons subject to regulation, and registration of applicants. In deciding whether or not to assist an overseas authority, CIMA must take into account whether corresponding assistance would be given to it by the relevant country or territory; whether the inquiries relate to the possible breach of a law or other requirements which has no close parallel in the Cayman Islands; the seriousness of the matter; the importance of the information to the inquiries; and whether in the light of the advice from the Attorney-General or the Financial Secretary it is in the public interest to give the assistance. CIMA may not disclose information to an overseas regulatory authority unless it has satisfied itself that the overseas Authority is subject to adequate legal restriction of further disclosure which must include the provision of an undertaking of confidentiality. The MAL allows CIMA to enter into MoUs for the purpose of assisting consolidated supervision by the foreign supervisor. According to the MoUs that CIMA has entered into so far (Brazil and Jamaica), CIMA, where it has information that will assist the overseas authority in the performance of its regulatory functions, provides this information spontaneously, even though the overseas authority has made no request. In this respect, CIMA provides the home country supervisor sufficient information on any material remedial action it takes, after consultation with that authority, regarding the operations of a bank from that country. As part of its on-going supervisory process, CIMA's inspectors visit home countries and meet with home country regulators. CIMA also facilitates visits of foreign regulators to the Cayman Islands and routinely conducts joint inspections of banks for the purpose of consolidated supervision. The following regulators have either conducted on-site inspections, commissioned

	external auditors to conduct inspections, or made supervisory visits to the Cayman Islands: the Central Bank of Brazil, the United Kingdom Financial Supervisory Authority, the Bermuda Monetary Authority, the Isle of Man Financial Services Commission, the Swiss Federal Banking Commission, and a number of United States regulatory agencies.
Assessment	Largely Compliant.
Comments	Concerning the prudential supervision of branches, CIMA relies on the home supervisor of the bank, with respect to ensuring capital adequacy of the banking group and the fitness and propriety of directors and management. However, for the purpose of the licensing process as well as ongoing supervision, CIMA assesses whether consolidated supervision is conducted by the home supervisor in accordance with internationally recognized standards. It will not grant a license to a branch unless it receives confirmation from the home supervisor that there is no objection to the establishment of an office in the Cayman Islands and that the branch will be included in the consolidated supervision of the parent entity. The MAL should be amended to clarify that CIMA may provide unsolicited information to the home supervisor concerning the specific subsidiaries and branches under CIMA's jurisdiction. CIMA may wish to consider requiring assigned capital for those braches of foreign banks that are licensed to provide services to customers in the local banking market (i.e., "A"-licensed branches that provide retail banking services). This would provide comparable protection to the interests of these customers as is provided by the capital of the locally incorporated banks that are licensed to deal with the same clientele. It is not in line with international best practices that the supervisory authority needs the approval of another authority to enter into MoUs with foreign authorities and, also, that it has in the case of a non-routine regulatory request to take into account the advice of another authority whether to disclose information to foreign authority or not, since this may give room for political interference and weaken the independence of CIMA.

Table 1.2. Summary Compliance of the Basel Core Principles

Core Principle	C[1/]	LC[2/]	MNC[3/]	NC[4/]	NA[5/]
1. Objectives, Autonomy, Powers, and Resources					
1.1 Objectives	**X**				
1.2 Independence		**X**			
1.3 Legal framework	**X**				
1.4 Enforcement powers	**X**				
1.5 Legal protection	**X**				
1.6 Information sharing	**X**				
2. Permissible Activities	**X**				
3. Licensing Criteria		**X**			
4. Ownership	**X**				
5. Investment Criteria		**X**			
6. Capital Adequacy	**X**				
7. Credit Policies		**X**			
8. Loan Evaluation and Loan-Loss Provisioning		**X**			
9. Large Exposure Limits	**X**				
10. Connected Lending		**X**			
11. Country Risk		**X**			
12. Market Risks	**X**				
13. Other Risks	**X**				
14. Internal Control and Audit	**X**				
15. Money Laundering	**X**				
16. On-Site and Off-Site Supervision	**X**				
17. Bank Management Contact	**X**				
18. Off-Site Supervision		**X**			
19. Validation of Supervisory Information	**X**				
20. Consolidated Supervision	**X**				
21. Accounting Standards	**X**				
22. Remedial Measures		**X**			
23. Globally Consolidated Supervision	**X**				
24. Host Country Supervision		**X**			
25. Supervision Over Foreign Banks' Establishments		**X**			

[1/] C: Compliant.
[2/] LC: Largely compliant.
[3/] MNC: Materially non-compliant.
[4/] NC: Non-compliant.
[5/] NA: Not applicable.

Recommended action plan and authorities' response to the assessment

Recommended action plan

27. Although the most recent amendment of the MAL granted CIMA independence, the Governor retains the authority to approve the issuance of rules, and statements of principal and guidance and the signing of MOUs with other supervisory authorities by CIMA. The Cayman Islands Legislative Assembly may wish to reconsider the involvement of the Governor in these matters.

28. CIMA should use its existing authority to impose monetary penalties for violating prudential requirements issued in the Rules. The MAL should be amended to increase the currently permitted, minimal monetary penalties to significant amounts.

29. CIMA may wish to consider requiring assigned capital for those braches of foreign banks that are licensed to provide services to customers in the local banking market (i.e.,, "A"-licensed branches that provide retail banking services). This would provide comparable protection to the interests of these customers as is provided by the capital of the locally incorporated banks that are licensed to deal with the same clientele.

Table 1.3. Recommended Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
CP 1(2) Independence	CIMA should be able to issue rules and statements of guidance without the approval of the Governor.
CP 3 Licensing Criteria	CIMA should require that applicants maintain initial capital funds in cash in the jurisdiction.
CP 5 Investment Criteria	Criteria for judging proposals for investment and acquisition should be included in law or regulation.
CP 7 Credit Policies	CIMA should develop and implement a Statement of Guidance on Investment Risk Management.
CP 8 Loan Evaluation and Loan-Loss Provisioning	CIMA should require that loan loss provisioning reporting include off-balance sheet items. CIMA should provide for the implementation of an asset classification system in each licensee.
CP 10 Connected Lending	CIMA should require that transactions with connected or related parties exceeding specified limits have board approval and loans to connected and related parties be monitored by an independent credit administration process.
CP 11 Country Risk	CIMA should complete the issuance of its Statement of Guidance on Country/Transfer Risk.
CP 18 Off-Site Supervision	CIMA should include information on asset classifications in its regular required reporting.
CP 22 Remedial Measures	CIMA should use its authority to impose monetary penalties and the MAL should be amended to increase the permitted monetary penalties to significant amounts.
CP 24 Host Country Supervision	The MAL should be amended to permit MOUs for consolidated supervision by CIMA and permit CIMA to provide unsolicited supervisory information to host country supervisors.
CP 25 Supervision of Foreign Banks' Establishments	The MAL should be amended to permit CIMA to provide unsolicited supervisory information to home country supervisors.

Authorities' response to the assessment

CIMA notes that the IMF mission has assessed banking supervision as "compliant" or "largely compliant" with all 30 recommendations included in the 25 Core Principles. The

mission's recommendations are under review or implementation, as set out below, unless otherwise indicated.

CP 1, 3, 5, 22, 24, 25

Implementation of the IMF recommendations would require legislative changes to either the BTCL or the MAL. Legislative proposals on CP's 3 and 5 have already been submitted to the government, and a proposal from CIMA on CP 22 is under development. Regarding CP's 24 and 25, while there are no specific provisions in the MAL permitting CIMA to provide unsolicited information to home/host country supervisors, the MAL does not restrict such disclosures where the information is already public or where disclosure would assist CIMA in carrying out its supervisory duties under the Law. However, legislative change to expressly permit the provision of unsolicited supervisory information to home/host country supervisors will be put forward by CIMA for consideration by the government.

Regarding CP 1(2), CIMA believes that the current process allows for transparency and accountability and does not interfere with its operational independence.

CP 7, 8, 10, 11, 18

Implementation of the IMF recommendations would require CIMA to issue new or amended Rules or Statements of Guidance. The necessary Statements of Guidance or Rules to respond to the recommendations, *on Investment Securities and Derivative Risk Management*; *Loan Loss Provisioning*; *Asset Classification; Credit Risk Management; Country and Transfer Risk Management*, have either been issued to the industry for consultation or are under development.

II. IOSCO Objectives and Principles of Securities Regulation

A. General

30. The assessment of observance of the IOSCO Objectives and Principles of Securities Regulations (IOSCO Principles) in the Cayman Islands was undertaken as part of the offshore financial center assessment program. In the Cayman Islands, the Cayman Islands Monetary Authority (CIMA) is responsible for the supervision of all financial services with the exception of the Stock Exchange, which is regulated by the Stock Exchange Authority. Mr. Michael Deasy from the Central Bank of Ireland was the assessor.

Information and methodology used for assessment

31. The assessment was based on the Methodology for Assessing Implementation of IOSCO Objectives and Principles of Securities Regulation. The assessment was influenced by the structure of the securities market on the Islands. The licensing/registration of collective investment schemes (mutual funds) is an important element of securities activities; the Stock Exchange has a listing function only and a formal regulatory regime for market intermediaries has only recently been introduced.

32. The assessment was based on a review of the relevant legislation (i.e., primary legislation and regulations) and statements of guidance/ guidance notes issued by CIMA. It was also based on relevant information and a completed draft of the IOSCO assessment template submitted by CIMA. This information was supplemented by a review of a report carried out and published in 2000 on behalf of the U.K. Government on financial regulation in the Caribbean Overseas Territories and Bermuda and of other private sector reports available on the website. Detailed discussions were held with relevant representatives from CIMA, the Stock Exchange Authority, and the Stock Exchange as well as with relevant representatives from the private sector.

33. Cooperation was freely given by all concerned.

Institutional and macroprudential setting, market structure

34. The Monetary Authority Law (2003 Revision) sets out the broad supervisory powers of CIMA, and the Stock Exchange Company Law (2001 Revision) grants power to the Stock Exchange Authority to supervise the Exchange. In the securities area the Monetary Authority Law is supplemented by two other laws—the Mutual Funds Law (2003 Revision) and the Securities Investment Business Law (2003 Revision). The Mutual Funds Law provides for the licensing/registering of mutual funds as well as the licensing and supervision of mutual fund administrators. The Securities Investment Business Law provides for the licensing and supervision of investment business firms (e.g., asset managers, investment advisors, brokers, etc). The financial sector is serviced by a sophisticated and well-developed legal and accounting sector.

35. The Stock Exchange has a listing function only i.e., it does not engage in trading. Currently there are about 700 listings on the Exchange, the vast majority being mutual funds. Even though it does not trade, it has 6 member brokers, 5 of which are affiliated to banks. These are execution brokers only and have obtained their broker status to facilitate

their being able to deal on overseas exchanges and as a means of lending support to the Exchange in its earlier years (it was established in 1997). Under the Mutual Funds Law, CIMA as of June 2003 has licensed/registered 4457 funds; 3835 are registered and 46 licensed. A third category, administered funds (576), are those for which a licensed mutual fund administrator on the Islands provides its Principal Office. The distinguishing feature of the registered funds is that they have a minimum investing threshold of US$50,000 and they are targeted at sophisticated investors only. In theory, licensed funds are opened to the public but in practice, they are also targeted at sophisticated investors. It would appear that less than ten funds could be described as truly available to the public. The overwhelming majority of funds are in fact hedge or hedge-type funds. There are 183 licensed fund administrators on the Islands. These are permitted to carry out fund investment activity as well as normal fund administration activities, although in practice the fund management activity is almost invariably carried out overseas. Many of the major international fund administration companies are represented on the Islands. The Securities Investment Business Law was brought into effect in July 2003. It is unclear how many intermediaries will fall to be supervised under it—existing intermediaries have until January 2004 to apply for a license. The six broker members of the stock exchange will now be regulated by CIMA rather than the Exchange. In addition, less than ten other firms (most of which are affiliated to banks) will initially fall to be regulated under the Law, as far as can be ascertained. These firms are largely asset managers and their customer base seems to be exclusively institutions and high net worth individuals (e.g., financial institutions, trust companies, mutual funds etc.) A market does not exist on the Islands for retail intermediary business.

General preconditions for effective securities regulation

36. In broad terms, the supervisory regime reflects those of developed countries. It is influenced by EU legislation and rules, given the Islands' connection with the United Kingdom. A sound legal, taxation and accounting framework appears to be in place in the Islands.

Principle-by principle assessment

37. The IOSCO Principles were assessed in accordance with the Methodology for Assessing Implementation of IOSCO Objectives and Principles of Securities Regulation, taking into account the particular circumstances of the Cayman Islands Markets.

38. A Principle will be considered ***implemented*** whenever all assessment criteria are generally met without any material deficiencies. The Principles acknowledge that there are often several ways for countries to implement the Principles. A Principle will be considered to be ***broadly implemented*** whenever only minor shortcomings are found, which do not raise major concerns and when corrective actions to achieve full implementation with the Principle are scheduled and are realistically achievable within a short period of time. A Principle will be considered ***partly implemented*** whenever significant shortcomings are found, and the authorities have not implemented one or more assessment criteria. A Principle will be considered ***not implemented*** whenever major and material shortcomings are found in adhering with the assessment criteria. A Principle will be considered ***not applicable*** whenever it does not apply given the structural and institutional conditions.

39. **Regulator (Principles 1–5)**—The regulatory responsibilities of the Monetary Authority are clearly set down in various pieces of legislation and it applies them in a clear consistent manner. While in broad terms CIMA operates independently, there are a number of provisions in the Laws and Regulations, generally involving the power of the Governor, which could compromise this independence. It is recommended that these be deleted. The securities division suffers from a very serious deficit in staff numbers. While recruitment is underway, it will take some time for a cohesive and effective division to emerge.

40. **Self-regulatory organizations (Principles 6–7)**—The Stock Exchange has the sole right to operate one or more exchanges in the Cayman Islands. Currently there is only one exchange—the CSX—and it confines its activities to listing only (i.e., no trading is transacted). It is responsible for ensuring compliance by its broker members with its membership rules. It is supervised by the Stock Exchange Authority, which is a statutory body independent of CIMA. There are convincing arguments for CIMA to become its regulator.

41. **Inspections, investigations and enforcement (Principles 8–10)—**CIMA has sufficiently broad powers to carry out inspections, investigations and enforcement. However, power to carry out inspections of mutual fund administrators should be explicit in the Mutual Funds Law rather than relying on a general provision in the Monetary Authority Law. CIMA should also consider receiving additional information (e.g., half-yearly management accounts) from all licensees as an additional means of early detection of difficulties.

42. **Information sharing and cooperation (Principles 11–13)**—There is provision for the sharing of information with overseas regulators. However, these provisions contain clauses which introduce an element of subjectivity into deciding on whether information should be passed on to the overseas regulator. Also, for non-routine requests from overseas regulators, the advise of the Financial Secretary and the Attorney must be sought. Memoranda of understanding are permitted but only with the permission of the Governor and currently they are restricted to requests to assist the overseas regulator to supervise on a consolidated basis.

43. **Issuers (Principles 14–16)—**The listing rules of the Stock Exchange provide for full, accurate and timely disclosure of financial results and other information that is material to investors' decisions. It also provides that all holders of securities in a company are treated in a fair and equitable manner. Accounting and auditing standards are in line with best international practice.

44. **Collective Investment Schemes (Principles 17–20)—**The supervisory regime for collective investment scheme is designed to accommodate funds that are targeted at sophisticated/ institutional investors and indeed the overwhelming majority of funds, many of them hedge funds, are targeted at that market. In addition to administered funds for which a licensed mutual fund administrator provides a principal office, there are two broad categories of funds—registered funds which carry a minimum subscription of US$50,000 and licensed funds which have no minimum subscription and, in theory at least, are open to the general public. For such funds, the current regime is inadequate. There is an absence of standard consumer protection requirements (e.g., segregation of client assets). In practice, many of these requirements will be included in fund offer documents. Nonetheless, it is

recommended that CIMA introduce formal consumer protection requirements in respect of funds that are open to the general public. Also, it is recommended that CIMA revise upwards the threshold of US$50,000 (which was fixed in 1993) for registered funds to reflect international norms in this area. In general, the Mutual Funds Law is in need of overhaul, particularly when compared to the Securities Investment business Law. It will be noted that throughout this report, several recommendations suggest the inclusion in the Mutuals Fund Law of provisions similar to those in the Securities Investment Business Law.

45. **Market Intermediaries (Principles 21–24)—**The Securities Investment Law Act, which came into effect in July 2003, brought market intermediaries within the supervisory framework for the first time. It is a solid piece of legislation and should provide a sound basis for the effective supervision of intermediaries provided it has adequate and well trained staff to operate it. One provision of the Law is undesirable—Section 19 provides that if an auditor, either in the course of carrying out an audit or in carrying out a special audit on the licensee's anti-money systems and procedures, becomes aware of serious shortcomings, he must immediately give written notice to CIMA and the licensee of his knowledge or believe giving reasons therefore. The fact that the licensee is receiving knowledge at the same time as CIMA could compromise the ability of CIMA to take corrective action and in the case of an anti-money laundering audit could amount to tipping off. Accordingly, the Law should be amended to provide for the receipt of such reports by CIMA only

46. **Principles for the Secondary Market (Principles 25–30)**—As the Stock Exchange does not engage in trading this section is not applicable.

B. Detailed Assessment

Table 2.1. Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

Principles Relating to the Regulator	
Principle 1.	**The responsibilities of the regulator should be clear and objectively stated.**
Description	Securities for the purposes of the IOSCO Principles covers market intermediaries, collective investment schemes (mutual funds) the stock exchange and its member brokers. All of these exist in the Cayman Islands and all but the stock exchange is regulated by the Cayman Islands Monetary Authority (CIMA). The stock exchange is regulated by the Stock Exchange Authority. Overall responsible for the supervision of the financial services business (with the exception of the stock exchange) is vested in CIMA. Section 6 of the Monetary Authority Law (2003 Revision) states that one of the principal functions of CIMA is to regulate and supervise financial services business carried on in or from within the Islands in accordance with this Law and the regulatory laws. It is also charged with monitoring compliance with money laundering regulations. Detailed supervisory responsibility for market intermediaries is set out in the Securities Investment Business Law (2003 Revision) and for mutual funds in the Mutual Funds Law (2003 Revision). In both instances, supervisory responsibility is clearly and objectively stated. The Stock Exchange Company Law (2001 Revision) provides for the supervision of the Exchange. Section 3 of the Law states that the Stock Exchange Authority (Authority) shall be

	responsible for the policy, regulation and supervision of the Exchange. The Authority is an autonomous body established under the Law. Prior to the enactment of the Securities Investment Business Law in July 2003, the Exchange was responsible for the supervision of its brokers members. Under the Law, CIMA is now responsible, although the Exchange retains responsibility for the implementation of the broker membership rules.
Assessment	Fully implemented.
Comments	The overall legal framework for the supervision of securities appears satisfactory. Some deficiencies were identified in the detail of the various Laws—these are dealt with under the relevant Principles.
Principle 2.	**The regulator should be operationally independent and accountable in the exercise of its functions and powers.**
Description	In broad terms, CIMA, in respect of its supervisory responsibility for the securities sector, and the Stock Exchange Authority, in respect of its supervisory responsibility for the Stock Exchange, have operational independence. However, there are a number of provisions in some of the laws and regulations, which could, theoretically at least, compromise that independence. Under Section 50 of the Monetary Authority Law, CIMA may enter a memorandum of understanding with an overseas regulator only with the approval of the Governor. It is suggested that CIMA be given full discretion in deciding whether or not to enter such memoranda. Under Section 33 of the same Law it is stated that the Governor may, from time to time, after consultation with the board, give to the Authority, in writing, such general directions as appear to the Governor to be necessary in the public interest, and the Authority shall act in accordance with such directions. This provision raises questions about the operational independence of CIMA. Section 34 allows CIMA to issue or amend rules or statements of principles or guidance concerning the conduct of licensees and money laundering regulations only with the approval of the Governor. Again, this raises questions about operational independence. Under Section 49 of the Law, dealing with the exchange of information with overseas regulators, all but routine queries from overseas regulators must be referred to the Attorney-General and Financial Secretary. It is suggested that CIMA should have the sole power to deal with all legitimate regulatory queries from overseas regulators and that it should be at the judgment of CIMA whether or not to refer them to the Attorney-General and Financial Secretary. In relation to the regulation of the Stock Exchange by the Stock Exchange Authority (whose membership comprises the Financial Secretary, CIMA, the Attorney-General and at least two other members appointed by the Governor), the terms of reference for the members are set out in the Stock Exchange Authority Regulations (2001 Revision). Regulation 6 states, "The Governor may, at any time, revoke the appointment of any member." Regulation 2 states "The members of the Authority shall hold office during the pleasure of the Governor." It appears in reality that these provisions apply only to the non-specified members of the Authority, i.e., they did not apply to the Financial Secretary, CIMA, or the Attorney-General. In any event, the tenure of members of any supervisory body should be subject to objective criteria and dismissal should be for stated reasons only. On the question of accountability, the Monetary Authority Law requires the Authority to prepare annual audited accounts (Section 40) and Section 41 provides for an independent review of the Authority's performance of any of its functions. Under the Securities Investment Business Law (Section 16) the Authority must maintain a general review of securities business

	and submit an annual report thereon to the Governor in Council. (There is no similar provision in the Mutual Funds Law).
Assessment	Partly implemented.
Comments	While in broad terms there is operational independence, the issues referred to above could compromise that independence. On the question of accountability, it is recommended that a provision similar to Section 16 of the Securities Investment Business Law be inserted in the Mutual Funds Law.
Principle 3.	**The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.**
Description	Under the various laws governing the securities sector, the powers of CIMA and the Stock Exchange Authority, in their capacities as regulators, appear adequate subject to certain relatively minor amendments. The Securities Investment Business Law contains wide supervisory powers, for example, on authorization, attaching conditions to licenses, inspections powers, enforcement/revocation powers, etc. Similarly, powers under the Mutual Funds Law appear adequate with one exception—there is no provision to cancel/ rescind a registered or administered fund (this issue is dealt with under Principle 17). In the case of the Stock Exchange Authority, there is no explicit provision for it to inspect the Stock Exchange (This issue is dealt with under Principle 7). The lack of resources is a very serious constraint to the effective work of the securities division. It is currently without a head or deputy head and five staff members have left in the past year. Currently staff numbers total 13. CIMA is very much relying on overtime to help meet the workload. The Board of CIMA has given priority to its staffing needs and has planned for a staff complement of between 20 and 25 by end 2004. Recruitment of a head is at an advanced stage. CIMA is aware of the difficulties of coping with a sudden influx of staff and as a result has prioritized training in this area also.
Assessment	Partly implemented.
Comments	The lack of staff is a major shortcoming in the securities division. While CIMA has plans to increase numbers substantially it will take some time for the division to become a cohesive working unit A well thought out training program will be essential.
Principle 4.	**The regulator should adopt clear and consistent regulatory processes.**
Description	The rules governing CIMA's supervisory powers and processes in the securities field are set out clearly in the relevant Laws, Regulations and statements of guidance/guidance notes. There is no reason to believe that they are not carried in an impartial and fair manner. There is a comprehensive consultative process on the introduction of new laws, regulations and CIMA is required by law to consult the industry when proposing new statements of guidance/guidance notes. CIMA has wide powers of enforcement and when exercising these powers against a licensee the latter has a right to make appropriate representations. For instance, under Section 17(3) CIMA is required to notify the licensee of any proposed action and the licensee may make representations and where a decision is taken by the Authority it can be appealed to the Court. In any event, it is always open to a licensee to seek a judicial review of a CIMA decision.
Assessment	Fully implemented.
Comments	None.
Principle 5.	**The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.**
Description	Section 49 of the Monetary Authority Law imposes obligations on all regulatory staff with regard to confidentiality. Any director, officer, employee, agent or advisor of the Authority found in breach of the confidentiality requirements is guilty of an offence and liable on

	summary conviction to a fine of US$12,500 and to imprisonment for one year, and on conviction on indictment to a fine of US$62,500 and to imprisonment for three years. Section 18 of the same Law requires directors and senior management of CIMA to declare any interest they may have in any licensee that is being discussed in their presence. CIMA has also issued Codes of Conduct and Codes on Conflicts for Directors. In essence, Directors are required to carry out their CIMA responsibilities to the exclusion of any personal gain and to avoid any situation involving a conflict or the appearance of a conflict between their interests and the performance of their official duties. Similar provisions for staff are contained in the staff handbook.
Assessment	Fully implemented.
Comments	None.
Principles of Self-Regulation	
Principle 6.	**The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.**
Description	The sole SRO in the Cayman Islands is the Cayman Island Stock Exchange (Exchange). It was established in 1997 pursuant to the Stock Exchange Company Law 1996. Under the Law, the Exchange has the sole right to operate one or more securities markets in the Cayman Islands for the listing and trading of securities. The Exchange has published three sets of rules books governing securities activities: the listing rules; the membership rules and the code on takeovers and mergers. While the Exchange has both a listing and trading function, currently it provides a listing function only. Mutual funds comprise the vast majority of its 700 listings. The main reason these companies seek a listing is for marketing purposes (e. g., many funds require a listing before certain types of investors will invest in them). The Exchange has six broker members even though is does not carry out trading activities. Five of the six are part of banking groups. These are execution only brokers and have obtained broker status to facilitate their being able to deal on overseas exchanges and also as a means of lending support to the Exchange, particularly in its earlier years. Until recently, brokers were authorized and supervised by the Exchange; that supervisory regime included on-site inspections of the brokers. Following the passing of the Securities Investment Business Law (2003 Revision), brokers are now supervised by the Monetary Authority, although the Exchange retains responsibility for the implementation of the broker membership rules. These rules are comprehensive and are based on best international practice. Part V of the Securities Investment Business Law governs the relationship between CIMA and the Exchange and provides for exchanges of information between both bodies. In particular, the Exchange is required to submit a written report to CIMA when it becomes aware of a serious issue involving a broker. However, in submitting the report to CIMA, it must also simultaneously send a copy to the institution in question. This requirement is in effect an impediment to the free exchange of information between the two bodies in that for legal reasons the Exchange has to be very careful in drafting a report, which also must be sent to the broker in question.
Assessment	Implemented.
Comments	As an SRO the Exchange appears to carry out its function in a professional and competent manner. However, the provision in the law which requires it to send a copy of an investigatory report to the broker in question at the same time as it is sending it to CIMA should be deleted to facilitate a free exchange of information between the two bodies.
Principle 7.	**SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.**
Description	The Stock Exchange is not supervised by CIMA but by the Stock Exchange Authority (the

	Authority), a statutory body established under the Stock Exchange Law,1996 and independent of CIMA. It is responsible for "the policy, regulation and supervision of the Exchange." Its membership comprises the Financial Secretary (Chairman), CIMA, the Attorney General and not less than two other members appointed by the Governor on the recommendation of the Financial Secretary. It has no employees. Meetings are held at the discretion of the Chairman and are generally quarterly, although to date this year (October 2003) only two meetings have been held. The Exchange provides the Authority with a monthly report on its activities as well as on monthly income. The Stock Exchange Law makes no provision for the Authority to carry out an inspection of the Exchange even though it seems to be accepted that it can. To date no inspection has taken place. (Issues relating to the independence of the members of the Authority are discussed under Principle 2 which deals with operational independence of regulators)
Assessment	Partly implemented.
Comments	The legislation should be amended to give the Authority clear authority to carry out an inspection of the Exchange. Thereafter, given that the Exchange is in existence for six years, an inspection should be carried out. The question arises as to whether the Exchange should be supervised by CIMA rather than the Authority. There are arguments in favor of CIMA. It has the necessary supervisory framework. It also recently assumed responsibility for the supervision of member brokers and there is provision in the Securities Investment Business Law (Section 36) for cooperation between CIMA and the Exchange on their supervision.
Principles for the Enforcement of Securities Regulation	
Principle 8.	**The regulator should have comprehensive inspection, investigation and surveillance powers.**
Description	Section 16 of the Securities Investment Business Law sets out CIMA's powers in relation to its inspection and investigation and surveillance functions of securities firms. It specifies that CIMA is responsible for their supervision and enforcement. It is also responsible for the investigation of persons where the Authority reasonably believes that they are or have been carrying out investment business without authorization. In supervising licensees under that Law, CIMA may whenever it considers it necessary examine, by way of the receipt of regular returns, on-site inspections, auditor's report or in such other manner as the Authority may determine, the affairs or business of any licensee for the purpose assessing whether a licensee is undertaking its authorized activities in accordance with the Law and any regulations made under this Law. Under the Mutual Funds Law CIMA does not have explicit power to examine the books and records of a mutual fund, although it may at any time under Section 23 instruct a regulated mutual fund to have its accounts audited and submitted to it. Nor does the Law have explicit powers of inspection and investigation in respect of mutual fund administrators (which are regulated under that Law) CIMA does carry out inspections of these administrators but does so under a general provision (Section 36(i) of the Monetary Authority Law. Section 36(i) states that the Authority may do any thing, which is calculated to facilitate, is incidental to or consequential upon the exercise of its duties under this Law.
Assessment	Broadly implemented.
Comments	CIMA should seek explicit powers to directly examine the books and records of a mutual fund and to carry out inspections and investigations of mutual fund administrators, as is provided for in the Securities Investment Business Law in respect of investment firms, rather than rely on a general provision.
Principle 9.	**The regulator should have comprehensive enforcement powers.**
Description	Section 17 of the Securities Investment Business Law provides CIMA with wide ranging enforcement powers in respect of investment businesses. It can revoke licenses, impose conditions, apply to the Court for any order which is necessary to protect the interests of clients

	of licensees, remove a director or officer, appoint a controller, etc. Section 18 contains provisions relating to injunctions, restitution and disgorgement orders. Section 20 provides that where a breach of the Law is suspected CIMA can apply to the Court for entry into premises. Under Section 30 of the Mutual Funds Law, CIMA can revoke a mutual fund license, impose conditions, remove promoters/operators of the fund, appoint a controller, etc. In the case of a registered or administered fund, however, there is no provision for cancelling/rescinding the registration (This issue is dealt with in Principle 17).
Assessment	Fully implemented.
Comments	None.
Principle 10.	**The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.**
Description	CIMA carries out on-site inspections of licensees. No inspections have been carried under the Securities Investment Business Law, given the newness of that Law, but it has and does carry out inspections of fund administrators under the Mutual Fund Law. In the case of the administrators, it aims to inspect them once every three years. To date it seems to have met this target. It uses a detailed inspection manual in carrying out the inspections. It also employs a risk-based approached in deciding which firms to inspect. This is based on the regulatory history of the firm, its size, the number of funds under administration, complaints received about the firm, etc. Thus, to detect suspected breaches of the law and regulations in a timely and effective manner CIMA relies on the receipt of annual accounts and its inspections. Under the Securities Investment Business Law (Section 19) there is an obligation on the external auditor to inform CIMA if he becomes aware of difficulties in the licensee. A similar provision exists in Section 34 of the Mutual Funds Law. For all licensed entities in the securities sector it is recommended that CIMA consider requiring them to submit half yearly management accounts – this would assist in the earlier detection of difficulties. Also, it is recommended that CIMA when introducing rules relating to the net asset values of funds (see Principle 20) require the funds to submit these calculations at regular intervals. An analysis of these calculations can often help identify difficulties in individual funds.
Assessment	Broadly implemented.
Comments	Subject to the recommendation that half yearly management accounts be submitted by licensees and net asset value of funds be also submitted, CIMA broadly meets this requirement Overhanging these suggested improvements is the need to have adequate and well trained staff to carry out these functions.
Principles for Cooperation in Regulation	
Principle 11.	**The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.**
Description	Section 49 of the Monetary Authority Law deals with the exchange of information with overseas regulators. The Law makes a distinction between "routine regulatory requests" and other requests. Routine regulatory requests are defined as requests for the purpose of allowing the overseas regulator to carry out its day-to-day functions of approval of licenses, approval of persons subject to regulation and registration of applicants. The routine regulatory requests can be dealt with by CIMA without reference to any other body whereas for all other requests (which, for example, could deal with market abuse or market manipulation) CIMA must notify the Financial Secretary and the Attorney-General of the request and both can give their advice on the matter. Also, Subsection (4) states that in deciding whether or not to assist an overseas regulator CIMA shall take into account (a) whether the inquiries relate to the possible breach of a law or other requirement which has no close parallel in the Islands or involve the assertion of a jurisdiction not recognized by the Island (b) the seriousness of the matter to which the inquiries relate, the importance to the inquiries of the information sought in the Islands and (c) except in the case of a routine regulatory request, whether in the light of advise from the Attorney-General or the

	Financial Secretary, it is not in the public interest to give the assistance sought. It could be argued that these provisions introduce an element of subjectivity into the decision-making process that could result in information not being transmitted which, when looked at from a purely regulatory perspective, should have been transmitted. As an example of how effective its exchange of information is, CIMA quoted the following figures: Between 2 May 2002 and 23 September, 2003 CIMA received 158 requests for information, 154 have been responded to and 4 are pending. Of the 154, 146 were routine and 8 were non-routine. The 8 related to such issues as share manipulation and false information. On the domestic front, Section 36 of the Securities Investment Business Law provides for the exchange of information between CIMA and the Stock Exchange. This is in response to the transfer of supervisory responsibility for brokers from the Exchange to CIMA. There is no provision for the exchange of information between CIMA and the Stock Exchange Authority, the body responsible for the supervision of the Exchange.
Assessment	Partly implemented.
Comments	The Authorities should consider giving CIMA the sole right in deciding how to deal with requests from overseas regulators. They should also consider deleting the clauses referred to above as introducing an element of subjectivity into the decision-making process in respect of overseas requests. Provision should be made for the exchange of information between CIMA and the Stock Exchange Authority.
Principle 12.	**Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.**
Description	This description should be read in conjunction with that of Principle 11. Section 50 of the Monetary Authority Law allows CIMA, with the approval of the Governor, to enter into memoranda of understanding with overseas regulatory authorities for the purpose of assisting consolidated supervision by such authorities.
Assessment	Partly implemented.
Comments	It is suggested that CIMA should not have to have the approval of the Governor to enter into memoranda of understanding with overseas regulators and that the scope of such memoranda go beyond consolidated supervision.
Principle 13.	**The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.**
Description	Section 34(9) of the Monetary Authority Law states that where CIMA is satisfied that assistance should be provided in response to a request by an overseas regulator, it may direct in writing a regulated entity or a person reasonably believed to have information relevant to the enquiries to which the request relates, to provide CIMA with all necessary documents and give to CIMA such assistance in connection with those inquiries as CIMA may specify in writing. Where an entity/person fails to comply with the foregoing CIMA may apply to the Court to have that entity/person comply with the direction.
Assessment	Fully implemented.
Comments	None.
Principles for Issuers	
Principle 14.	**There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.**
Description	The rules relating to disclosure are set out in the Listing Rules issued by the Stock Exchange. They are comprehensive and reflect best international practice. Chapter 2 contains the general listing requirements and procedures. The listing rules are intended to ensure that investors have and can maintain confidence in the market and that the issue and marketing of securities is conducted in a fair, open and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of the issuer, and of the securities for which listing is sought. They also provide for investors to be informed by the issuers of any new developments, which are not of public knowledge, and in particular that immediate disclosure is made to the Exchange of any information which might reasonably be

	expected to have a material effect on market activity in, and the prices of, the issuers' listed prices. The listing department of the Exchange monitors compliance with the above requirements. It reviews the initial documentation to ensure that the documentation contains clear and comprehensive disclosure of all relevant information relating to the issue in accordance with the listing rules. The listing department also oversees the issuer's continuing obligations. The issuer must submit its audited annual accounts to the Exchange for review. Rule 9.67 specifies other disclosure requirements including notification to the Exchange without delay of any material change to the issuer's constitutional documents, any change in the rights of shareholders and any material change in the general character or nature of the issuer. (For more detailed information on timely disclosure, etc in relation to listed mutual funds see Principle 27—Regulation Should Promote Transparency of Trading.)
Assessment	Fully implemented.
Comments	Both the rules and the oversight of their implementation by the Exchange appear satisfactory.
Principle 15.	**Holders of securities in a company should be treated in a fair and equitable manner.**
Description	Similar to Principle 14, the rules relating to fair and equitable treatment of holders of securities are set out in the Listing Rules (Chapter 2) issued by the Stock Exchange. In this respect, Section 2.7 provides that all holders of listed securities of the same class must be treated fairly and equally and that the directors of an issuer must act in the interests of its shareholders as a whole, particularly where the public represents only a minority of the shareholders. Under "continuing obligations," issuers must meet several requirements in relation to fair treatment of security holders either by communicating directly to the security holder or to the Exchange for dissemination to the holder. The relevant areas include new developments, equality of treatment, exercise of rights, dividends, and financial information. As part of its monitoring function as described in Principle 14, the listing department of the Exchange monitors compliance with these requirements. Apart from the provisions of the Listing Rules relating to fair treatment of securities holders, under company law companies must not act oppressively towards any minority shareholders. Section 94 of the Companies Law provides those circumstances in which a company may be wound up by the Court. In circumstances where shareholders are oppressed, the Court uses this remedy.
Assessment	Fully implemented.
Comments	Both the rules and the oversight of their implementation appear satisfactory.
Principle 16.	**Accounting and auditing standards should be of a high and internationally acceptable quality.**
Description	All licensees in the securities (investment intermediaries, brokers, mutual funds, mutual fund administrators, etc) must prepare annual audited accounts. Copies of these accounts must be submitted to CIMA. In the case of mutual funds where the audit is carried out in an overseas jurisdiction, the local office of the auditor which carried out the audit must sign- off on the accounts (i.e. verifying that it is satisfied with the audit) CIMA stipulates in the various relevant laws that only auditors with internationally recognized qualifications can audit licensees. The "big four" accounting firms, together with a number of accounting firms which specialize in hedge funds audits, are strongly represented on the islands. They operate to best international practice.
Assessment	Fully implemented.
Comments	Required accounting and auditing standards are generally acceptable accounting standards recognized internationally.

Principles for Collective Investment Schemes	
Principle 17.	**The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.**
Description	The mutual funds sector is an important part of the financial services industry in the Cayman Islands. It is regulated by the Mutual Funds Law (2003 Revision)(the "Law"). The Law provides for three types of funds- licensed funds (of which there are currently 46), administered funds (576) and registered funds (3835). The Law also provides for an exempt class, i.e., a fund with less than 15 investors where the majority of these are capable of appointing or removing the manager. Also, close-ended funds (i.e., those were investors are 'locked in' for a given period of time) fall outside the scope of the Law. Licensed funds are theoretically open to the public, although in practice there appears to be less than ten funds, which could be said to be invested in by the general public. Registered funds (accounting for more than 85 percent of total funds) have a minimum investor subscription of US$50,000. Administered funds are those for which licensed mutual fund administrators ("MFA's)—see below—provide a principal office in the Islands. In doing so, MFA's are required to satisfy themselves that the promoter of the fund is of sound reputation and that the business of the mutual fund will be carried out in a fit and proper manner. The Law also provides for the licensing of mutual fund administrators (MFA's) by CIMA. MFA's are permitted to carry out fund investment activity as well as normal fund administration functions, although in practice the fund investment activity is almost invariably carried out overseas. Many of the major international fund administration companies are represented on the islands. MFA's are subject to a normal regulatory regime i.e. licensing, inspections, sanctions, revocations etc. Three types of fund administrators are permitted under the Law—full administrators which can provide administrative services to an unlimited number of funds; restricted administrators which can provide services to a limited number of funds (in practice these act for just one family of funds) and exempted administrators which act for just one fund). Currently there are 98 full administrators, 77 restricted administrators and 8 exempted. The Law sets down broad principles for the supervision of mutual funds, for example, fit and proper requirements for promoters, managers etc. of the fund, (although this does not apply to registered funds); a requirement that the prospectus contain such information as is necessary to enable a prospective investor in the mutual fund to make an informed decision as to whether or not to subscribe to the fund; the ability to impose conditions on the fund, to appoint a controller should CIMA consider this warranted, an obligation to submit annual audited accounts; the ability to revoke a license (although there is no provision to cancel/ rescind the registration in the case of a registered or an administered fund). Like many offshore centers, a very significant part of the work associated with mutual funds (e.g. investment management, administration, custody) is delegated overseas. The regime in respect of registered funds, most of which are hedge funds, appears adequate (subject to certain amendments i.e. provision for the cancellation of the registration of a registered or administered fund and a reconsideration of the US$50,000 threshold—see below) on the grounds that these funds are targeted at sophisticated investors and that in other jurisdictions such funds would fall outside the regulatory framework. In this connection, however, the threshold of US$50,000, which was originally set in 1993, is low by international standards and it is recommended that CIMA revise this figure upwards in line with international practice in this area. While in practice the number of truly retail funds is miniscule, in theory licensed funds are open to the public without any minimum subscription. Accordingly, the broad principles set out in the Law are insufficient to meet the consumer protection criteria detailed in this and the

	following three Principles and it is recommended that CIMA introduce detailed rules to address this problem. Specific recommendations will be put forward in each of the four Principles and in the case of this Principle, the following recommendations are suggested. The drawing up of rules to deal with, for example, potential conflicts of interest between investors and operators of the funds and the use of delegates where functions have been delegated. In addition, given that the Law defines a mutual fund as "the pooling of investor funds with the aim of spreading investment risks" it is recommended that CIMA provide guidance on how that spread could be achieved (e.g., diversification of investment). When these rules and those recommended under the following three Principles are established, compliance with them should be monitored on a continuous base by CIMA.
Assessment	Partly implemented.
Comments	The regime for registered funds is considered adequate subject to providing for the cancellation of the registered and administered funds and a reconsideration of the US$50,000 threshold for entry into such funds. In the case of funds that are open to the public, CIMA should introduce detailed rules relating to the consumer protection issues identified in the description. It should also ensure ongoing compliance with these rules when adopted. In general, the Mutual Funds Law would benefit from a revision, particularly when compared to the Securities Investment Business Law. As will be seen throughout this report, there are a number of recommendations which suggest the inclusion in the Mutual Funds Law provisions in the Securities Investment Business Law.
Principle 18.	**The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.**
Description	This description should be read in conjunction with that of Principle 17. The legal form of collective investment scheme is provided for—they can take the form of a limited company, a unit trust or a partnership. There is no provision for the segregation of client assets at present although draft guidelines are currently being prepared on the issue.
Assessment	Partly implemented.
Comments	It is recommended that CIMA draw up detailed binding rules relating to the segregation of client assets for funds that are open to public.
Principle 19.	**Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.**
Description	This description should be read in conjunction with that of Principle 17. Section 3(6) of the Law specifies that the offer document should describe the investments in which the fund invests in all material respects and that it should contain such other information as is necessary to enable a prospective investor in a mutual fund to make an informed decision as to whether or not to subscribe for the fund. As a broad principle this is fine. However, CIMA should draw up detailed rules on how this principle should be met in the case of funds open to the public. For instance, it should specify the rights of investors in the fund, information on the promoters and other associated with the fund, the investment objectives and policy, procedures for purchases, redemptions and pricing of units, information on the risks involved in investing in the funds, fees and charges associated with the fund. In practice, offering documentation will contain this information but in the interests of clarity and the protection of investors and potential investors, CIMA should include them in its rules for the licensing of mutual funds on sale to the public.
Assessment	Partly implemented.
Comments	It is very important that the investing public has as much information as possible to inform its investment decisions.

Principle 20.	**Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.**
Description	This description should be read in conjunction with that of Principle 17. There is no regulation ensuring that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units of a fund, although CIMA is in the process of drawing up such a rule. When CIMA draws up its rules, it should require each fund to submit details of its net asset value at regular intervals e.g. monthly or quarterly. Such information can act as a very useful supervisory tool in that, for example, it can show significant movements in individual funds, which could lead to further supervisory enquiries. Also, it would facilitate the calculation of the total net asset value of funds licensed/registered by CIMA—information not currently available at present.
Assessment	Not implemented.
Comments	In practice, all funds will calculate a net asset value but CIMA should draw up detailed requirements relating to the matter.
Principles for Market Intermediaries	
Principle 21.	**Regulation should provide for minimum entry standards for market intermediaries.**
Description	Prior to the coming into effect of the Securities Investment Business Law, 2003 in July 2003 there was no dedicated provision for the supervision of investment intermediaries in the Cayman Islands (some investment intermediaries were supervised by virtue of their business activities described under the Companies Management Law or the Mutual Funds Law). Pursuant to the 2003 Law all intermediaries engaged in investment business (e.g., the purchase and sale of shares, bonds etc, asset management, investment advice, etc) must seek authorization from CIMA. Intermediaries dealing exclusively with sophisticated persons (e.g., regulated entities and knowledgeable investors investing at least US$100,000 in the case of each transaction) and/or high net individuals (e.g., an individual with a net worth of at least US$1million) can seek an exemption from the provisions of the Law. The Law meets the necessary requirements under this Principle—detailed fit and proper criteria, adequate initial and ongoing capital requirements (based on EU rules), ability of CIMA to carry out on- and off-site regulation, requirement on auditors to report material breaches, adequate provision for imposing penalties and the withdrawal of licenses, etc. Under Section 11 of the Law, Regulations have been issued on the following issues: advertising by intermediaries; full and proper disclosure to clients; standards for dealing with clients and clients' assets; standards for financial conduct and record keeping and reporting; disclosure requirements in respect of commissions or other inducements; arrangements for the settlement of disputes. CIMA is currently in the process of preparing guidance notes, in consultation with the industry, on each of the above issues. Under Section 19 of the Law, if an auditor, either in the course of carrying out an audit or in carrying out a special audit on the licensee's anti-money laundering systems and procedures becomes aware of serious shortcomings, he must immediately give written notice to CIMA and the licensee of his knowledge or belief giving reasons therefore. The fact that the licensee is receiving knowledge at the same time as CIMA could compromise the ability of CIMA to take corrective action and in the case of an anti-money audit could amount to tipping off. Accordingly, the Law should be amended to provide for the receipt of such reports by CIMA only. (It is unclear how many intermediaries will fall to be supervised under the new Law—existing intermediaries have until January 2004 to apply for authorization. The six broker members of the Stock Exchange will now be regulated under the Law rather than by the Exchange. In addition, less than ten other firms (most of which are affiliated to banks) will initially fall to be

	regulated under the Law, as far as can be ascertained. These firms are largely asset managers and their customer base seems to be exclusively institutions and high net worth individuals (e.g., financial institutions, trust companies, mutual funds etc. A market does not exist on the islands for retail intermediary business.)
Assessment	Broadly implemented.
Comments	With the exception of the provision dealing with the simultaneous receipt of an auditor's report by CIMA and the licensee in question, which should be amended as suggested above, the legislation should provide a framework for the effective supervision of intermediaries. However, it will only be effective if it has sufficient and appropriately trained staff in place to operate it.
Principle 22.	**There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.**
Description	This description should be read in conjunction with that of Principle 21. Section 11(2)(d) of the Securities Investment Business Law (the "Law") requires a licensee to establish financial requirements and specify standards for financial conduct and record keeping and reporting. Under the same Section, a Regulation has been made setting out the capital adequacy requirement to be met by licensees. In furtherance of this Regulation CIMA has prepared a draft guidance note for consultation with industry on the calculation of the ratio. The capital adequacy requirement is based on EU law in this area. All Intermediaries must have initial capital (US$125,000 in the case of asset managers, brokers etc., and US$22,500 in the case of advisors) On an ongoing basis intermediaries are required to hold capital in line with the EU Capital Adequacy Directive which takes into account the activities of the intermediary as well as risk factors, such as counterparty and position risks. In any event, intermediaries are required to hold the higher of initial capital or the equivalent of one quarter of relevant annual expenditure. In addition, CIMA reserves the right to adjust the relevant annual expenditure if there is a significant change in the licensee's circumstances or activities, or if the licensee has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the licensee. Brokers are required to make monthly capital adequacy returns; all others on a quarterly basis.
Assessment	Broadly implemented.
Comments	These requirements meet best international practice. Again, they will only be effective if there are sufficient staff to implement them.
Principle 23.	**Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.**
Description	This description should be read in conjunction with those of Principles 21 and 22. The Law, relevant Regulations and draft guidance notes address these issues. The Regulation on financial requirements and standards (Section 6) specify that a licensee shall maintain internal systems and controls and risk management processes that are adequate for the size, nature and complexity of its securities investment business activities. A separate Regulation has been issued on conduct of business. It contains the usual items covered in such codes – advertising standards, standards for dealing with clients (including provisions for client agreements and complaints procedures) and client assets and money. Section 3(4) of these Regulations require licensees to maintain at all times professional indemnity and appropriate insurance to cover the professional liability of senior officers and business interruptions.
Assessment	Broadly implemented
Comments	The Law, Regulations and draft guidance notes in this area are sufficient to meet the requirements of this Principle. Again, however, staffing problems will be an issue.

Principle 24.	**There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.**
Description	This description should be read in conjunction with the three previous descriptions. Section 17 of the Securities Investment Business Law provides a wide range of remedies to CIMA where it knows or has reasonable grounds to believe that a licensee is or appears likely to become unable to meet its obligations as they fall due or is behaving fraudulently or has failed to comply with relevant laws or regulations or has mismanaged its business. These remedies include revoking the license, imposing conditions, applying to the Court for any order which is necessary to protect the interests of clients or creditors of the licensee, including an injunction or restitution, appointing a controller, removing directors, etc. Section 18 allows the Court, if it is satisfied that there is a reasonable likelihood that a licensee will contravene the Law or any relevant Regulation or engage in fraudulent activity, to grant an injunction restraining the contravention or anticipated contravention or the law activity. The Court may also order a person and any other person who appears to the Court to have been knowingly concerned in a contravention, to take such steps as the Court may direct for restoring the parties to the transaction to the position in which they were before the transaction was entered into.
Assessment	Fully implemented.
Comments	The powers in Sections 17 and 18 of the Law appear sufficiently wide-ranging to deal with the failure of an intermediary so as to minimize damage and loss to investors and to contain systemic risk.
Principles for the Secondary Market	
Principle 25.	**The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.**
Description	Currently the Stock Exchange provides listing facilities only. No trading is undertaken. The Exchange has developed an electronic web-based trading platform and is currently in the process of developing its systems further with a view to commencing trading in domestic and international equity securities.
Assessment	Not applicable.
Comments	None.
Principle 26.	**There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.**
Description	The Stock Exchange is supervised by the Stock Exchange Authority. (See details at Principles 6 and 7). The Exchange seeks to maintain its overall integrity by its monitoring of listings and member brokers through its listing rules and membership rules.
Assessment	Not applicable.
Comments	None.
Principle 27.	**Regulation should promote transparency of trading.**
Description	While no trading occurs at the Exchange, it does monitor and publish the net asset values (NAV) of listed mutual funds, which accounts for the vast majority of listings. Each listed fund must report its NAV to the Exchange every time it is calculated, which must be at least quarterly. In practice, most funds calculate their NAV's on a daily, weekly or monthly basis. Reporting to the Exchange is done via a secure internet page. Upon receipt of this information, the prices are immediately published on the mutual fund listing page on the Exchange's internet website. It is also sent to Bloomberg for posting to the relevant trading and information pages. The Exchange monitors the changes in the NAV's through a fully automated process. Exception reports are generated every morning. In addition, e-mails are automatically generated and sent off to issuers who have failed to post their NAV's to the Exchange on time.
Assessment	Fully implemented.

Comments	While the Exchange does not have a trading operation as such, its procedures for ensuring transparency and the monitoring of that transparency are adequate.
Principle 28.	**Regulation should be designed to detect and deter manipulation and other unfair trading practices.**
Description	False or misleading market practices and dealing were outlawed for the first time in the Securities Investment Business Law, 2003. Section 24 states that anyone who creates or does anything which is calculated to create a false or misleading appearance of active trading in any listed securities or a false or misleading appearance with respect to the market for, or the price of, any such securities is guilty of an offence. Similarly, insider dealing is outlawed under Section 25. The Law also defines insiders. Even though there is no trading on the Stock Exchange, its membership rules provide detailed rules on market manipulation and insider dealing. When monitoring compliance with the provision of its handbook, the Exchange will have regard to these issues. The Stock Exchange, under its membership rules, can pass information to any authority, agency or body having responsibility for the supervision of financial services or for law enforcement, whether in the Cayman Islands or elsewhere. The Exchange is also a Member of the Intermarket Surveillance Group, an international body of self-regulatory organizations committed to confidential market information sharing for regulatory purposes including information relating to violations of trading and conduct of business rules.
Assessment	Fully implemented.
Comments	Taking the provisions of the Monetary Authority Law and the Stock Exchange handbook together and the absence of trading on the Exchange, the regulatory regime appears sufficient to detect and deter manipulation and other unfair trading practices.
Principle 29.	**Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.**
Description	Since there is no trading on the Exchange and brokers act in an intermediary capacity only this issue does not arise.
Assessment	Not applicable.
Comments	None.
Principle 30.	**Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.**
Description	As no trading takes place at present this question has no relevance for the Cayman Islands
Assessment	Not applicable.
Comments	None.

Table 2.2. Summary Observance of the IOSCO Objectives and Principles of Securities Regulation

Assessment Grade		Principles Grouped by Assessment Grade
	Count	List
Implemented	12	1, 4, 5, 6, 9, 13, 14, 15, 16, 24, 27, 28.
Broadly Implemented	5	8,10,21,22,23.
Partially Implemented	8	2,3,7,11,12,17,18,19
Not Implemented	1	20
Not applicable	4	25,26,29,30

C. Recommended Actions and Authorities' Response to the Assessment

Recommended actions

Table 2.3. Recommended Plan of Actions to Improve Observance of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (CP 1–5)	Remove legal impediments that could compromise independence. Increase staff numbers and prioritize training.
Principles of Self-Regulation (CP 6–7)	Remove provision in SIBL, which stipulates that broker must receive copy of CSX inspection report at same time as CIMA. Stock Exchange Law should be amended to give Stock Exchange Authority clear authority to carry out inspection of Exchange. Carry out inspection of Exchange. Consider transferring supervisory responsibility for the Stock Exchange from the Stock Exchange Authority to CIMA.
Principles for the Enforcement of Securities Regulation (CP 8–10)	Ensure sufficient staff numbers to continue inspection program, particularly following introduction of Securities Investment Business Law. Consider obtaining additional information (e.g. .half yearly management accounts) from licensees to enhance supervision
Principles for Cooperation in Regulation (CP 11–13)	Give CIMA sole responsibility for dealing with requests from overseas regulators. Consider removing provisions which introduce an element of subjectivity into the decision-making process in respect of overseas requests for information. Provision should be made for the exchange of information between CIMA and the Stock Exchange Authority. CIMA should have sole discretion into deciding with whom to enter into a memorandum of understanding. Extend the scope of memoranda of understanding beyond consolidated supervision.
Principles for Issuers (CP 14–16)	No recommendations.
Principles for Collective Investment Schemes (CP 17–20)	Introduce a more prescriptive regime from a consumer protection prospective for funds open to the general public. Require all funds to calculate their net asset values. Revise upwards the threshold figure of US$50,000 for registered funds. Provide for the cancellation of registered and administered funds. Revise Mutual Funds Law generally to bring it more in line with

Reference Principle	Recommended Action
	modern supervisory concepts (for example, include a parallel provision to s. 16 SIBL; include specific inspection provisions in MFL rather than rely on general supervisory powers in MAL).
Principles for Market Intermediaries (CP 21–24)	Ensure sufficient staff resources to implement Securities Investment Business Law. Remove provision which requires an auditor's report to be sent to the licensee at the same time as it is being sent to CIMA.
Principles for the Secondary Market (CP 25–30)	No recommendations.

Authorities' response

CIMA notes that the IMF mission has assessed securities regulation against the IOSCO 30 Principles as "implemented" or "broadly implemented" for 17 Principles, "partially implemented" for eight and "not implemented" for one, with four "not applicable." The mission's recommendations are under review or implementation, as set out below, unless otherwise indicated.

CP 1–5

CIMA does not consider that the putative "legal impediments that could compromise independence" rise to that level. Respecting the sections of the MAL referenced in that regard, Section 33(1) allows the issuance to CIMA of "general directions as appear to the Governor to be necessary in the public interest." This section is not intended and has not been interpreted to mean directions on operational matters. Indeed, the only such direction ever issued, in October 2000, required CIMA to "advise all regulated service providers that aggressive marketing policies based exclusively or primarily on confidentiality or secrecy are not in the public interest." Section 49(3)[2] requires CIMA to send a copy of each request for assistance from an overseas regulatory authority that is not a routine request to the Financial Secretary and the Attorney General. This requirement does not amount to a veto on CIMA's decision to provide assistance: while CIMA is obliged to take any advice proffered by the FS or AG into account, it is not legally bound to follow the advice if there is good reason not to do so. Indeed this requirement is not repeated in Section 49(9) setting out the circumstances in which CIMA is obliged to refuse assistance.

Regarding the recommendation on staffing, CIMA is actively addressing this matter at Board level, in terms of required numbers of staff and funding, as well as training programmes. It is aimed to implement the agreed HR plan for the Investment & Securities Division in 2005.

CP 6–7

[2] In the 2004 revision of the MAL, section 49 is numbered 50.

The Stock Exchange Authority (SEA) notes that the mission's assessment of the operations of the CSX is positive (of the relevant 11 Principles, 5 were rated as "implemented," 2 as "broadly implemented" and 4 as "not applicable") and will consider the recommendations made, with regard to CSX inspections by the SEA. In fact, an inspection of the CSX commissioned by the SEA using external consultants was overtaken by the IMF assessment, and, thus, not pursued at that time.

CP 8–10

Previous comments under CP1–5 regarding staffing relate. CIMA proposes to address the recommendation regarding the obtaining of additional information by the introduction in early-mid 2005 of a new periodic reporting form (RF–2) for mutual funds.

CP 11–13

Previous comments under CP1–5 regarding independence of the regulator relate. Regarding the potential for subjectivity, CIMA does not consider that the decision-making process for providing assistance to overseas regulators in Section 49 MAL involves objectionable subjective elements. Many jurisdictions have similar legislative provisions in relation to the provision of assistance to overseas regulators. Indeed, the criteria set out in Section 169(4) of the U.K. Financial Services & Markets Act 2000 are identical to those in Section 49(4).

Regarding MOU's, CIMA has developed criteria for the execution of these with overseas regulators. The criteria have been approved by Cabinet and Cabinet has approved all MOUs that CIMA has submitted for approval. The scope of MOUs has been extended beyond consolidated supervision by virtue of an amended Section 50(1) MAL enacted in January 2004.

CP 17–20

CIMA has made initial recommendations to the government covering revisions to the MFL, which include an increase in the registered funds threshold to US$100,000. While, as the mission notes, the number of retail mutual funds is small, CIMA proposes to address the related IMF recommendation in early-mid 2005. A Statement of Guidance regarding the cancellation of registered and administered funds has been issued.

Regarding CP 20, which received the sole "not implemented' assessment, as the mission noted, CIMA is in the process of developing rules on net asset value calculation.

CP 21–24

Previous comments under CP1–5 regarding staffing relate. CIMA will address the IMF recommendation regarding auditors' reports with a view to making a recommendation to government on the relevant MFL provision.

III. Detailed Assessment Report on Observance of the IAIS Core Principles

A. General

47. This section provides summary findings from the assessment of the IAIS Core Principles.[3] The assessment was based on discussions held with staff of the Insurance Division of the Cayman Islands Monetary Authority, representatives from; domestic insurance companies, Insurance Managers Association of Cayman (who administer captive insurers), an auditor, and a consulting actuary. The assessment considered several documents:

- Insurance Law (2003 Revision)
- Monetary Authority Law (2003 Revision)
- On-Site Inspection Manual
- Off-site Inspection Manual
- Staff Handbook
- Reporting Schedule for Prudential And Statistical Returns to the Cayman Islands Monetary Authority 2002–2003, and the formats of the supervisory filings.

48. In addition, the assessment considered the KPMG Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda commissioned by the U.K. Government and the Caribbean Overseas Territories and Bermuda and published in 2000.

Institutional and macroprudential setting—overview

49. The insurance sector consisted of 769 insurance licensees; 28 domestic Class "A" Insurers, 613 Class "B" Insurers, 28 Licensed Managers, 22 Brokers, and 76 Agents at the time of the mission. Class "A" insurers are permitted to underwrite domestic risk; there are 4 locally incorporated companies and 24 branches of non-Cayman companies in this class. Class "B" companies are not permitted to underwrite domestic business and constitute the offshore insurance market. The majority of business (87 percent as at September 29, 2003) underwritten in the offshore market emanates from North America, and the major classes of business are Workers' Compensation, Medical Malpractice, and Products Liability being 25 percent, 24 percent, and 17 percent by premium volume respectively.

50. Captive insurers are classified according to their primary line of business. At September 30, the volume and nature of business in this market is given in Table 3.1, below.

[3] The assessment was conducted by Mr. D. N. Davies, International Monetary Fund.

Table 3.1. Cayman Captives by Primary Class of Business at September 30, 2003

Business Class	Number of Companies	Total Premiums	Net Income	Net Worth	Total Assets
Accident & Health	9	35,478	14,652	106,662	117,585
Alternative Risk Financing	3	13,127	(9,062)	6,446	60,874
Auto Liability	19	98,356	20,781	90,958	192,514
Credit Life	17	133,581	13,675	397,201	781,649
Crime	1	2,096	20	208	3,395
Deferred Variable Annuities	13	2,139	3,687	25,901	1,389,891
General Liability	57	172,704	26,252	172,589	904,834
Healthcare	201	1,170,993	(72,933)	534,840	4,708948
Life	15	208,018	20,053	357,004	2,101,185
Marine & Aviation	8	252,063	468	19,601	282,301
Products Liability	9	790,471	151,707	252,607	2,081,301
Professional Liability	61	380,440	67,070	330,310	1,403,537
Property	66	267,125	47,344	385,489	1,741,126
Surety Bonds	6	1,908	8,124	48,862	29,051
Workers' Compensation	128	1,147,979	44,332	867,005	2,843,730
TOTALS	613	4,676,477	336,171	3,595,680	18,641,921

Table 3.2. Cayman Captives (by organizational form)

Company Type	Number of Companies	Total Premiums	Net Income	Net Worth	Total Assets
Alternative Financing Vehicle	18	74,401	(4,407)	21,150	1,245,051
Association	71	348,246	13,101	267,308	1,193,258
Group Captive	43	523,477	12,281	426,579	1,304,224
Open Market Insurer	32	221,302	23,960	455,702	3,040,156
Pure Captive	370	3,290,873	296,116	2,321,977	11,122,180
Rent-A-Captive	7	16,303	(19,658)	7,982	75,963
Segregated Portfolio Company (341 Cells)	72	201,875	14,776	94,982	661,089
TOTALS	613	4,676,477	336,171	3,595,680	18,641,921

Source: CIMA

51. The supervision of insurance activity is based on the Insurance Law (2003 Revision) and it is the duty of the Cayman Islands Monetary Authority to undertake this task. CIMA was established as the supervisory authority pursuant to the Monetary Authority Law.

52. There is a strong professional infrastructure, with accountants and lawyers supporting the business operations; for example, insurance managers are experienced professionals, often qualified accountants. There is one actuary on the Island who is employed by a firm of accountants, but there appears to be an adequate supply of actuarial services from elsewhere. It is a characteristic of the Cayman Islands that the industry, the professionals and the Authority work closely for the furtherance of the good reputation and financial well-being of the Islands as an international financial center.

General preconditions for effective insurance supervision

53. The legislative framework for insurance supervision has been in place since 1979, with the first enactment of the Insurance Law. The current version of this law is the fifteenth revision, and it now contains a wide range of grounds for supervisory intervention and an appropriate range of remedies. The Insurance Division of CIMA has clearly made rapid progress in upgrading its legal base and working practices, but further progress is still needed to give a substantive legal or regulatory base to some of the more central prudential requirements.

Main findings

54. There is a very high number of licensees, and a high frequency of supervisory events; for example, there were 425 business plan changes and 195 prudential meetings in the first half of 2003. At the time of the mission, the Insurance Division was comprised of nine highly competent members of staff and the headcount was budgeted to increase to fourteen. The program of on-site inspections went into abeyance when staff resources were temporarily depleted but we understand they were to re-commence in December 2003. On-site inspections are a key supervisory tool ensuring adherence to strong corporate governance procedures and internal controls. Strong governance reduces the risks in an operation and focused inspections in this, and other areas of prudential importance, serve to increase the stability of a sector. The shortage of resources is, therefore, a pervasive supervisory issue.[4]

55. The Cayman insurance sector chiefly comprises of offshore captive insurers. It has been common to regard captives as being of lower risk than open market insurers because each of them has a very limited policyholder base. Nevertheless, the major classes of business are third party liability protections where the beneficiaries are other than the policyholders. In this context, consumer protection is a wider issue than policyholder

[4] The shortage of resources for insurance supervisory functions is almost universal, and CIMA is certainly not unique in this respect. Nevertheless, the fact that onsite inspections went into abeyance because of the absence of one member of staff is evidence of the shortfall in the ability of CIMA to provide continuous, high-quality supervision.

protection. Under such circumstances, it is appropriate to impose prudential requirements that protect beneficiaries.

56. Recommendations are proposed for the Authority to consider its prudential conventions over asset valuation, liability valuation, solvency, and capital adequacy. The considerations should account for asset price volatility (which has become more pronounced in recent years) reserve volatility (which is historically high in liability classes of business) and the capital buffers necessary to protect consumers. Considerations should also account for the nature of the Cayman market.

57. Prudential rules governing assets, liabilities, solvency, and capital adequacy should be risk-based and formalized in law, regulation or rule to ensure transparency and consistent application.

58. The Insurance Division has an effective automated system for the collection and analysis of data from the supervisory filings. However, the data contained in such filings could be extended to include some of the information required to be given in a business plan. This would broaden the analytical capabilities of the system and could be designed to reduce the manual input into the ad hoc supervisory events. The benefit of this would be to allow staff to spend greater time on risk-based activities such as focused on-site inspections.

B. Detailed Assessment

Table 3.3. Detailed Assessment of Compliance of the Insurance Core Principle

Principle 1.	**Organization of an Insurance Supervisor** The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. It should, at any time, be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the insurance supervisor should: • be operationally independent and accountable in the exercise of its functions and powers; • have adequate powers, legal protection, and financial resources to perform its functions and exercise its powers; • adopt a clear, transparent, and consistent regulatory and supervisory process; • clearly define the responsibility for decision-making; and • hire, train, and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.
Description	The Cayman Islands Monetary Authority (CIMA) was established under the Monetary Authority Law (MAL), the current version of which dates from June 10, 2003. This law establishes the independence of the Authority subject to certain overriding controls that ensure accountability. For example, pursuant to Sections 11 to 14, the appointment of Directors must be made by the Governor and, in particular, s14(3) states that the Governor may dismiss a director in the public interest. Furthermore, s14(1) states that a director may not also be a member of the Legislative Assembly or an official member of the Executive Council. These provisions reduce the likelihood of political influence over the Authority, but

vest power in the Governor as the ultimate arbiter of competence and independence.
In practice, the supervisory staff of the Authority work closely with industry participants on the development of policy issues—this serves to bring about pragmatic solutions to the issues that arise and greatly enhances the efficiency of the process. It is a particular characteristic of the Cayman Islands system that the industry, professions and official bodies work in close association for the furtherance of the financial well-being and good reputation of the Islands as an international financial center. There is no evidence that the Authority cannot take the decisions that it needs for the performance of its duty, but it is noted that the degree of co-operation between the industry and the authorities is closer than in the majority of jurisdictions and, in this wider context, gives the appearance that the Authority has less independence from industry than is desirable.

The Insurance Law s5(1) sets out the duties of the Authority with respect to insurance supervision and covers the issuance and revocation of licenses, the assessment of licensees and the market as a whole, and compliance with law.

The Insurance Division of CIMA appears to be a very well managed and efficient team. It has a budgeted headcount of 14 staff, but currently has 5 vacancies. It is, therefore, under resourced and this is particularly marked when set against the fact that it supervises 769 licensees (as at September 30, 2003). The current licenses are: 615 Class “B” Insurers, 28 Class “A” Insurers, 28 Licensed Managers, 22 Brokers, and 76 Agents.

The decision making process is clear. There are four groups which, in increasing order of authority, are:

(a) Assessment meetings. These are twice-weekly staff meetings that discuss and prepare cases for escalation. The agendae are retained, but these meetings are informal.
(b) Management Committee. This is comprised of Heads of Divisions, Legal Department., Compliance Department and Managing Director. This is a formal meeting for which minutes are recorded. This committee has the authority to issue licenses for Class "B" Insurers. Members of the Management Committee are subject to a specific Code of Conduct.
(c) Executive Board. Formal proceedings and minutes are retained. It is empowered to issue licenses to Class “A” Insurers and must approve the use of sanctions against all licensees.
(d) Full Board. Formal proceedings. Referrals made to the full board if the implications of the case are uncertain, unusual or particularly sensitive. It is empowered to take advice from third parties including legal advice from QC; the terms of reference for any consultant are drafted by the legal department. The assessor was told that decision making at this level is effective and flexible, and board referral has worked well—even when board members are away from the Island.

The quantity of supervisory activity for the six months from January to June 2003 is given in the following table.

	Actual	Budget
Issue of new licenses	48	25
Receipt of annual returns	668	720
Changes of shareholder / director	279	300
Business plan changes	425	350
On-site inspections	0	10
Enforcement actions	5	15
Prudential meetings	195	250
Proposals for Regulatory Laws	5	1

The table shows an onerous workload for the headcount (9). Many of these events are time consuming and demand a great deal of technical expertise, for example, the examination of business plan changes which also necessitate a meeting with the company—although a business plan change could be a change of auditor, and this would not consume technical expertise, or require a meeting.

	CIMA is empowered to outsource functions, and such third parties are subject to the same rules of confidentiality and professionalism as staff. The Authority has availed itself of this power from time to time, which has included the inward secondment of a qualified accountant. Nevertheless, the lack of local professional resources (for example, there is only one actuary on the Island) may pose a problem for the Insurance Division. The Authority, its officers and employees are immune from liabilities arising from their actions on behalf of the Authority provided that they acted in good faith (MAL s43). The Authority has recently made efforts to codify its working practices into law or policy papers. Until recently, its modus operandi was characterized by informal working practices and "rules of thumb" which were communicated to the industry largely through informal channels. The progress should be continued to ensure that substantive legal basis is given to the rapidly improving form of supervision. The said policy papers serve as guidance to the industry and, in the event of a dispute, Courts would be bound to account for this guidance. Nevertheless, guidance does not have the full force of law, and the body of insurance law and regulation could be strengthened by the codification of the emerging body of policy papers.
Assessment	Materially non-observed.
Comments	During the mission, the close association between the supervisor, the professions and the insurance market participants was manifest. In fact, since the mission, CIMA have acknowledged this in a press release. This acknowledged close association was sufficient to raise doubts about the clarity and certainty of supervisory independence. <u>Other issues</u> Working practices should be codified and placed on the website. The Authority is under-resourced.
Principle 2.	**Licensing** Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor: • in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include proforma financial statements, a capital plan, and projected solvency margins; and • in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.
Description	The principle refers to the licensing of insurance business in the domestic market, thus is not, strictly speaking, applicable to the licensing of offshore entities. Nevertheless, the law defining the license requirements covers both onshore and offshore entities, so that they can be covered together in this assessment. Insurance Law s5(1)(d) states that it is the duty of CIMA to grant or revoke insurance licenses. The entities which must be licensed are given in Insurance Law s4 and are (a) Class "A" Insurers (b) Unrestricted Class "B" Insurers (c) Restricted Class "B" Insurers (d) Insurance Agents (e) Insurance Brokers (f) Insurance Sub-agents (g) Insurance Managers (h) Principal Representative. However, CIMA no longer issue licenses for Sub-agents or Principal Representatives. A Class "A" insurer is permitted to assume domestic risk. An unrestricted Class "B" insurer is permitted to assume risk arising outside the Cayman Islands and a Restricted Class "B" insurer is permitted to assume risk arising outside the Cayman Islands from a specifically approved counterparty or counterparties. Insurance Law s3 and s6 make it an offence to carry on insurance business without a license or to purport to, or hold oneself out to be carrying on insurance business without a license.

	CIMA has a draft policy paper on the licensing process, which covers: fit & proper persons (fit & proper is also addressed in statute), ownership, financial resources, internal controls, record keeping, KYC, compliance, and business plan contents. Ratification and publication of this paper would enhance transparency over their requirements in this area. Nevertheless, it appears that the requirements are well known by the financial community in the Caymans. They vetting of business plans and the "gate keeping" role of the licensing process consumes a great deal of effort in the Insurance Division, and the task appears to be undertaken conscientiously. Licensing decision-making authority within CIMA was described above, in ICP 1. CIMA are currently not legally bound to issue a reason for denial of license, although they acknowledged the desirability of such a requirement as being consistent with its status as an independent authority. Currently, the Monetary Authority Law requires CIMA to set out regulatory policies and procedures in its Handbook. The Handbook states that CIMA should record decisions and reasons for them and, where appropriate, communicate them to the applicant licensee. The assessor was told that no license is granted unless CIMA are able to trace ultimate beneficial ownership, and the only exception is in the case of publicly listed companies. The exchange of information between supervisors of overseas jurisdictions assists in the vetting process. The "gate keeping" function is strengthened by Insurance Law s7(3) which states that licensed insurers, other than approved external insurers, may only carry on business in accordance with the information given in the license application. Such insurers must furnish the Authority with an annual statement of compliance with this provision signed by an independent auditor, a licensed insurance manager or any other person approved by the Authority. Insurance Law s5(1)(b) limits the jurisdiction of CIMA to insurance businesses that have been carrying on business since June 17, 1980. This did not appear in the previous enactment of this statute, at which time there were no unsupervised entities. The assessor was told that the offending provision was an unexplained drafting error in the version presented to the legislature and that, in practice there are still no unsupervised entities in the Cayman insurance sector. The assessor saw the previous enactment of this law to verify CIMA's assertion.
Assessment	Observed.
Comments	No comment.
Principle 3.	**Changes in Control** The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should: • require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and • establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.
Description	Insurance Law s8(1) states that prior approval of CIMA is required for transfers or disposals of shares in excess of 5 percent of a licensee. An exemption is granted for publicly quoted companies under s8(2). Furthermore, Insurance Law s4(3) states that changes to the conditions that existed on granting a license must be notified to the Authority. Whereas this subsection is wider than ownership, it serves as an extra legal provision to ensure that the Authority is apprised of all relevant ownership changes.

	The table shown in ICP 1, above, indicates the activity in this area.
Assessment	Observed.
Comments	No comment.
Principle 4.	**Corporate Governance** It is desirable that standards be established in the jurisdictions that deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the insurance supervisor should set requirements with respect to: • the roles and responsibilities of the board of directors; • reliance on other supervisors for companies licensed in another jurisdiction; and • the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.
Description	The provisions relating to corporate governance are contained in the Insurance Law, the Onsite Inspection Manual, and a Core Policy Paper, the last of which is—at the time of writing—a draft that is subject to public consultation. Insurance Law s5(1)(b) states that it is the duty of the Authority—on its own motion to examine the affairs or business of any licensee or other person carrying on insurance business for the purpose of satisfying itself that this Law has been or is being complied with, and the licensee is in a sound financial position and is carrying on his business in a satisfactory manner. The explicit corporate governance aspects of "this Law" are confined to fit and proper criteria. Nevertheless, the fact that the business must be conducted in a "satisfactory manner" provides CIMA with the powers to enforce corporate governance and internal control criteria. A more comprehensive assessment is made of corporate governance compliance during the onsite inspection process. The On-site Inspection manual addresses itself to Class "A" Insurers and Managers of Class "B" Insurers. The manual states that, for Class "A" Insurers, the supervisor must establish: the key decision making and control center, the role of the Cayman board, the strategic plan and the comments of foreign supervisors. Furthermore, he must assess: the efficiency and suitability of management to execute policy and procedures, the attitude towards internal controls and the system of accountability. For Insurance Managers, the assessment covers (a) functional divisions, (b) technical competence, (c) adequacy of supporting staff, (d) extent and effectiveness of managing director supervision, and (e) availability and competence of professional support. The corporate governance characteristics of the Insurance Manager is rated on a scale of 1 to 5. We were told that the vast majority of managers were rated "2" being of high standing with modest weaknesses, while the others were rated "3," being sound with minor deficiencies. This assessment appears to be generally consistent with the fact that the major Managers are Cayman subsidiaries of reputable global insurance market practitioners. It must be noted in this context that Class "B" Insurers must have an Insurance Manager which must be licensed, and subject to supervision, in accordance with Insurance Law. The duties of directors are set out in Common Law and in Articles of Association of companies formed under Company Law. The only exemption granted to directors of exempted companies is not to be bound to hold their AGM on the Island. The draft CIMA Core Policy Paper on Corporate Governance is entirely consistent with the essential and additional criteria associated with this Core Principle. Full implementation of this Principle has not been achieved because onsite inspections are currently in abeyance, and this is discussed elsewhere. Nevertheless, in mitigation of this risk,

	prudential meetings are held with the representatives of each Class "B" every 24 months, and aspects of Corporate Governance can be dealt with during focused onsite inspections and other supervisory events.
Assessment	Largely observed.
Comments	Codification and full implementation of the provisions of the Inspection Manual and the Core Policy Paper, monitored by means of a systematic program of onsite inspections, would give the Cayman Islands an excellent Corporate Governance regime.
Principle 5.	**Internal Controls** The insurance supervisor should be able to: • review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and • require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.
Description	As noted for ICP 4, above, the Insurance Law, Inspection Manual and draft Core Policy Paper provide a comprehensive and regime for governance and internal control. The duties of directors are set out as described above (ICP4). The Annual Statement of Operations for Class "B" insurers provide further evidence of compliance with law (including the requirement to carry on business in a satisfactory manner—s5(1)(b)) which must be signed by a licensed insurance manager. From time to time, control failures become evident, and this is occurs in every market. Action is taken when such failures occur, and this is illustrated below, in the cases outlined in the comments to ICP14.
Assessment	Observed.
Comments	No comment.
Principle 6.	**Assets** Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address: • diversification by type; • any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables; • the basis for valuing assets which are included in the financial reports; • the safekeeping of assets; • appropriate matching of assets and liabilities; and • liquidity.
Description	Insurance Law s7(4) requires that Class "A" Insurers shall prepare independently audited financial statements under GAAP. GAAP is not defined in the law but most companies report under US GAAP, others may report under UK GAAP, Canadian GAAP or IAS. In addition, s7(6) states that all Class "A" and Class "B" companies carrying on long term business must have their assets and liabilities actuarially certified on an annual basis to enable the Authority to be satisfied on their solvency positions. Thus, the legal basis for the valuation of assets depends largely on the judgment of Directors and third party professionals. Directors and said professionals owe their primary duty of care to shareholders, and the absence of more prescriptive supervisory rules whose focus is on policyholder protection and financial stability is a clear gap. This is particularly important in view of the increased asset price volatility in recent years.

	In respect of domestic business, non-Cayman companies operating as a branch are subject to the "liability protection scheme" which is codified in Insurance Law s7(1). This section provides that such insurers must retain liquid assets to at least the value of their Cayman liabilities and that these assets be vested in a manner approved by the Authority. The supervisory filings of such insurers are formatted to enable the Authority to monitor this scheme, and all such insurers report on a quarterly basis. CIMA currently have a policy paper entitled "Asset Management and Investment Strategy For Insurance Companies." This paper reflects the criteria necessary for compliance with this Principle. The Insurance Division of CIMA deal with issues on a case-by-case basis using unmodified "rules of thumb." Some such rules are well established, for example they impose an unofficial limit of 20 percent equities in a portfolio of assets, and this is monitored through the reporting system—see ICP 12. The on-site inspection manual details procedures to verify compliance with law, regulations (whether official or unofficial) and international best practice. The issue of the frequency of inspections is mentioned elsewhere.
Assessment	Materially non-observed.
Comments	Standardization of asset valuation conventions for the various classes of company, as appropriate for the Cayman market, and their formalization in rules or regulation (together with the concepts in the above mentioned policy paper) would result in a higher assessment.
Principle 7.	**Liabilities** Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider: • what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary; • the standards for establishing policy liabilities or technical provisions; and • the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.
Description	The legal provisions in force covering the standards with respect to liabilities are contained in the Insurance Law s7(4) and s7(6). The former states that all insurers other than external insurers must furnish annual, independently audited, financial statements in conformity with GAAP (see ICP 12, below for further details). CIMA state that it imposes this requirement on external insurers also. The latter states that the assets and liabilities of all insurers carrying on life business must certified by an approved actuary, to enable the Authority to satisfy itself as to the solvency. CIMA state that it also requires annual actuarial reports from companies underwriting liability business. In respect of actuarial valuations, no confidence levels are stipulated. The law and regulations impose no specific standards on the establishment or valuation of liabilities, and the Authority thus places a great deal of reliance on the judgment exercised by the directors, auditors and actuaries and this is mentioned above, in ICP 6. Similarly, reliance is placed on these persons to value reinsurance recoverables, but CIMA have an unofficial yardstick for reinsurer security of an AM Best rating of A or better. On-site inspections would mitigate any prudential risk arising out of this flexible regime because any shortcomings in the application of prudential standards would become apparent. The recent absence of such inspections, due lack of resources, reveals a considerable, but not irremediable, measure of risk.

	In mitigation of this risk, CIMA has an unofficial requirement that captive insurers fund their risk to a 75 percent confidence level. This is analogous to setting reserves at this confidence level and comparable to, or better than, standards in most other jurisdictions. CIMA does not, however, monitor compliance with this requirement, deeming it to be of no useful purpose.
Assessment	Materially non-observed.
Comments	CIMA have the powers to impose the standards but chose to adopt a flexible approach, dealing with companies on a case-by-case basis. At its best, this pragmatic approach is capable of imposing bespoke prudential requirements on companies, but it is also capable of imposing a divergent opaque regime on the sector as a whole and even divergent conditions on companies with similar risk profiles. Conventions and working practices should be clarified for each type of company and embodied in law, rules or regulation.
Principle 8.	**Capital Adequacy and Solvency** The requirements regarding the capital to be maintained by companies which are licensed, or seeking a license, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.
Description	The statutory levels of capital are laid down in Insurance Law s9 and s10. They state that no license be granted, other than to a restricted Class "B" insurer, unless the net worth of the entity is equal to, or greater than: C$100,000 for non-life insurers, C$200,000 for life insurers and C$300,000 for composite insurers, and that it is a condition of the license that these limits are not breached. CIMA no longer issue licenses for composite insurers. The Guideline, mentioned below, states that the capital requirements are US$120,000 and US$240,000 for non-life and life insurers respectively. **Class "A" Insurers** Locally incorporated Class "A" insurers have been subject to the unofficial rule of having to maintain C$3million capital. During the mission, CIMA staff stated that this requirement was before the legislature for codification. As at May 2004, no change to the law has been effected in this respect. There are four locally incorporated Class "A" insurers, the remaining 24 are branches of non-Cayman companies and are subject to the "liability protection" scheme see ICP 6, above. **Class "B" Insurers** The prime means of monitoring solvency is the "statutory solvency ratio," see ICP 12, below. This is the ratio of net earned premiums to surplus. The general rule of thumb is 5:1, and the assessor was informed that this is applied flexibly, with deviations allowed for healthcare captives of not-for-profit organizations which constitute approximately one third of the Class "B" sector. The capital and solvency regime is flexible and is clearly still evolving. Further precision in law and regulation is necessary as part of this development, codifying current practices and clarifying the basis on which they are applied. There is no law or regulation that deals with double gearing within groups.
Assessment	Materially non-observed.
Comments	Insurance Law s18(e) empowers the Governor to make regulations prescribing capital and liquidity margins and ratios to be maintained by licensees. These powers have not been used to date. A Guideline entitled "Capital Adequacy For Class "B" Insurance Companies" appears on the CIMA website, but it is unclear whether this has the force of law. The Guideline is dated March 2001 and outlines the risks involved in an insurance business and the way in which they are addressed by CIMA in respect of Class "B" insurers. The flexibility in the valuation of assets and liabilities, relying largely on the judgment of third parties, together with the flexibility in setting solvency and capital requirements is the

	basis for the assessment.
Principle 9.	**Derivatives and "Off-Balance Sheet" Items** The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address: • restrictions in the use of derivatives and other off-balance sheet items; • disclosure requirements for derivatives and other off-balance sheet items; and • the establishment of adequate internal controls and monitoring of derivative positions.
Description	The law does not prohibit the use of derivatives. Generally, derivatives are not allowed, but this is an extra-statutory requirement that is imparted on a case-by-case basis. An investment strategy is required as part of the licensing process and proposed derivative activity is notified by this means, together with applications for change of business plan. The "Asset Management" policy, referred to in ICP 6 would apply to the use of derivatives, although they are not specifically mentioned.
Assessment	Materially non-observed.
Comments	This assessment follows that given for ICP 6, above—the same comments apply; in this context, the assessment does not imply further weakness.
Principle 10.	**Reinsurance** Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them. The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing: • the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverable and may take into account the supervisory control over the reinsurer; and • the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.
Description	The reinsurance arrangements of both Class "A" and Class "B" Insurers are subject to scrutiny at the licensing stage, as a result of a business plan changes and, during the regular monitoring of supervisory filings. The annual supervisory filings include copies of reinsurance contracts, which are discussed at the biennial prudential meetings. The practices involved in the vetting of reinsurance arrangements are in depth but not founded in law. There are, however, policy papers on both reinsurance and the assessment of business plan changes. The papers describe the practice of examining aggregate exposures, planned and actual risk retention and assessing the reinsurance arrangements in that light. CIMA keep abreast of rating changes of the major reinsurers to the Cayman companies. The general "rule of thumb" is that licenses will not be granted or business plan changes approved unless the reinsurers have an AM Best rating of A or better. The Policy Paper on Reinsurance applies to Class "A" Insurers and addresses the corporate governance and internal control aspects of reinsurance arrangements.

Assessment	Observed.
Comments	The domestic Cayman market is heavily reliant reinsurance, particularly in motor and property lines. In addition, many captives are, by nature, reinsurers – for example, those assuming Workers' Compensation. Supervisory practices are able to deal with the reinsurance arrangements of primary insurers and with reinsurers themselves.
Principle 11.	**Market Conduct** Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealing with their customers. Insurers and intermediaries should: • at all times act honestly and in a straightforward manner; • act with due skill, care, and diligence in conducting their business activities; • conduct their business and organize their affairs with prudence; • pay due regard to the information needs of their customers and treat them fairly; • seek from their customers information which might reasonably be expected before giving advice or concluding a contract; • avoid conflicts of interest; • deal with their regulators in an open and cooperative way; • support a system of complaints handling, where applicable; and • organize and control their affairs effectively.
Description	Intermediaries require licensing under the Insurance Law (see ICP 2, above) and, as such, are subject to fit and proper assessment. Likewise, the license of intermediaries may be suspended or revoked. Nevertheless, there are currently no specific laws, regulations or rules (see Comments section for the separate issues regarding health insurance) that govern the conduct of individuals or companies that have face to face dealings with the consumers. CIMA have, however, produced a Guideline entitled "Market Conduct—Class "A" Insurers and Brokers and Agents." Insurance division staff address market conduct issues during on-site inspections (issues over the frequency of such inspections are dealt with elsewhere). CIMA maintain a complaints register. This gives it an indication of the level of dissatisfaction of the consumer with the insurers or intermediaries. CIMA staff asserted that there were relatively few complaints, and that this was consistent with the type of jurisdiction. The complaints were mainly about quantum of claim and not about conduct of insurers or brokers.
Assessment	Observed.
Comments	The assessment is based on the relevance of the regime to the type of jurisdiction. In a relatively small community where no intermediary could afford to incur a poor reputation because to do so would ruin its business. Thus, the existence of a complaints register is sufficient to monitor market conduct standards. Health Insurance became a mandatory class in 1997/98. Several schemes have been in operation from a variety of private sector suppliers. Most notably, a scheme provided by a Lloyd's syndicate provided excellent benefits for its members. The benefits, however, exceeded the premiums paid and the syndicate made losses which caused it to decline to renew the policy. The resulting lack of cover caused difficulty for consumers wishing to

	comply with the requirement to be covered. Since this time, a Superintendent of Health Insurance was appointed as a position within the Ministry of Health. This position is responsible for administering the system and this includes investigating complaints. Health Insurance law and regulations address market conduct issues in this area.
Principle 12.	**Financial Reporting** It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections, and communication with actuaries and external auditors. A process should be established for: • setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports, and other information; • setting the accounting requirements for the preparation of financial reports in the jurisdiction; • ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and • setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction. In so doing, a distinction may be made: • between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and • between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.
Description	There are three formats for supervisory reporting, depending on the type of license: first, Class "A" Insurers that carry on domestic business and are locally incorporated; second, Class "A" Insurers that are incorporated elsewhere and carrying on Cayman domestic business through a branch; third, Class "B" Insurers that are prohibited from offering insurance to the domestic market. **Locally incorporated Class "A" Insurers** The reporting requirement is set out in Insurance Law s10(2) which covers audited returns in the prescribed format together with compliance certificates, actuarial valuations and lists of agents and brokers with whom the entity has done business in the period. **Approved External Class "A" Insurers** The reporting requirement is set out in Insurance Law s7(1)–(5). The reporting requirements are similar to those for locally incorporated companies but include additional data to verify that the branch is compliant with the "liability protection" scheme (see ICP 6, above). This scheme serves to ensure that the branch has sufficient local liquid assets to cover liabilities arising from local business. Detailed reporting requirements are set out in s10(1) which are centered on certification of aspects of prudential strength which include a certification of solvency or compliance from the home state supervisor.

Class "B" Insurers
The reporting requirement is set out in Insurance Law s10(3), which is limited to receiving a certification that audited accounts have been prepared— however, CIMA receive returns from all Class "B" Insurers in the form of an Income Statement and Balance Sheet and they "unofficially" require audited financial statements.

Supervisory returns, available from the CIMA website, are made by electronic means (with back-up hard copies), and the CIMA system is capable of generating ratios for monitoring purposes and overdue returns reports. This appears to be a highly efficient system which compensates for the relatively low headcount compared to the number of licensees. The ratios used are listed below, and described where necessary. They provide a succinct and relevant means of monitoring activity and, when combined with the high level of interaction with the industry, are an excellent base for the supervision of the financial performance of the Cayman Insurance Industry.

Ratio	Description
Statutory solvency ratio	Net earned premium to surplus
Trade based solvency ratio	Gross premium to surplus
Net earned premium to admitted surplus ratio	Same as statutory solvency ratio after deducting non-admitted assets (e.g., fixed assets) from surplus
Loss ratio	
Expense ratio	
Combined ratio	
Investment yield	
Net combined ratio	Addition of two preceding ratios
Change in net written premium	Change compared to prior year
Return on invested assets	
Return on equity	
Excess (deficit) room for equity investment	Expressed as an absolute amount, this is the excess or shortfall of equity investments compared to 20 percent of assets. CIMA impose an unofficial rule that equities should be no more than 20 percent of assets, see ICP 6, above.

All Class "A" Insurers report quarterly.

The majority of filings are received in US GAAP. This is because the majority of licensees are captives of US principals, whose own accounts are drafted in US GAAP. Filings are usually accepted in GAAP of the jurisdiction of the parent or principal, and this introduces a small element of non-standardization into the reporting regime. Nevertheless, it does not appear to be an impediment to supervision and has the positive advantage of imparting cost efficiency on the supervisory reporting process.

The electronic reporting forms for Class "B" Insurers are confined to Income Statement and Balance Sheet, contain no breakdown by type of business and do not facilitate the analysis of the development of loss reserves. The assessor was told, however, that loss reserve development is monitored manually on receipt of hard copy filings.

There appears to be a trend for principals to make more use of their captives with the clear implication of them accepting a greater diversity of business than was originally intended. Yet CIMA analyze the activity in the Class "B" market in terms of the business for which a captive was originally set up and thus do not capture the full range of business underwritten. Whereas CIMA keep up with changes to business plans, this is a manual process involving meetings and the examination of such plans. It seems clear, therefore, that enhancement to

	Class "B" filings would facilitate a great deal more monitoring to be conducted electronically, enabling manpower to be deployed in a more risk-based fashion. This is particularly important if the Class "B" market continues to grow.
Assessment	Largely observed.
Comments	The shortcomings in financial reporting relate primarily to the establishment of clear requirements for the valuation of assets, liabilities, and solvency margin. These have been assessed under ICPs 6 to 8. The financial reporting system is clearly a strength. Yet many processes are manual, for example dealing with changes to business plans on a case-by-case basis. It is recommended that CIMA undertake a feasibility study on extending the use of the reporting system to reduce the manual input into the many ad hoc supervisory events. For example, business plan requirements are well known and if much or all of this data were incorporated into the supervisory filings, the manual input to these events may be significantly reduced. This would free up resources which could then be deployed in a more risk-based fashion.
Principle 13.	**On-Site Inspection** The insurance supervisor should be able to: • carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and • request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.
Description	The on-site inspection manual is technically excellent. It covers the inspection of Class "A" Insurers and the Insurance Managers, thus covering the operations of the Class "B" Insurers. It details procedures to be followed in respect of the examination of all aspects of operations, together with planning, performing and follow-up procedures. Since commencing on-site inspections in 1998, all Class "A" companies have had either a full or a focused inspection, and seven insurance managers have had a full onsite inspection. A focused inspection involves looking at a specific aspect only, and they may be performed without notice. Nevertheless, as indicated elsewhere, no onsite inspections were carried out in 2003 to the date of the mission, but CIMA assert that they have since recommenced. The risks posed by the lack of on-site inspections are mitigated by the fact that event reporting (such as change in business plan) is extensive, market intelligence is a geographically small jurisdiction is fairly reliable and the requirement for annual audits entails at least one independent scrutiny of a company each year. In addition, the boards of captives are required to meet with CIMA every two years.
Assessment	Materially non-observed.
Comments	The discontinuance of on-site inspections due to the non-availability of one member of staff is a clear indication of the vulnerability of the system in providing a continuous, high-quality supervision.

Principle 14.	**Sanctions** Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include: • the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions; • the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and • the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.
Description	The Authority has a broad range of powers to take remedial action, and a broad range of grounds under which it can act. These are set out in Insurance Law s13. CIMA can also issue cease and desist orders under s12. A sample of three illustrative cases are given in the comments below. The powers to grant and revoke licenses have been described in ICP's 1 and 2, above. The Authority has the requisite powers to be fully compliant with this Principle, and can illustrate the use of those powers. In addition, it must be noted that the high degree of interaction with licensees, for example in the vetting of business plan changes, affords ample opportunity for the application of moral suasion, obviating the need for more formal action. All sanctions must be approved by the board, and published in the Gazette.
Assessment	Observed.
Comments	Three enforcement cases: Case 1, a Class "A" external insurer. The company failed to supply the required filings, breached conditions of the liability support scheme and an onsite inspection revealed serious weaknesses in controls and record keeping. Supervisory directives issued by the Authority and follow-up discussions proved fruitless. An actuary was appointed, at the company's expense, to investigate the problems. The report is currently awaited. Case 2, a Class "B" insurer. The company fell below the required net worth position and failed to supply audited financial statements. Meetings with the owners and the insurance manager failed to produce corrective action, including the injection of further capital. The license was suspended and a controller appointed to run the company. The controller reported that a significant amount of funds had been transferred out of the company prior to his appointment, and he is currently taking action to recover these funds. Case 3, a Class "B" insurer. The company entered into a sale agreement in early 2000, the directors resigned and were replaced by directors from the prospective purchaser. In April 2000, these purchasers initiated an action in a US Court for material misrepresentation and sought rescission. CIMA suspended the license in 2000 which was the strictest sanction available at that time. The directors from the prospective purchaser and the Insurance Manager resigned. The Authority appointed controllers who reported that the company was insolvent and without directors or a Manager. A petition to wind up the company and appoint Joint Official Liquidators has been lodged with the Courts.

Principle 15.	**Cross-Border Business Operations** Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction, and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that: • no foreign insurance establishment escapes supervision; • all insurance establishments of international insurance groups and international insurers are subject to effective supervision; • the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and • foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.
Description	Pursuant to Insurance Law s3, all entities carrying on insurance business must be licensed. All branches and companies receive equal treatment during the licensing process, regardless of home state. CIMA approve all changes to business plans so they can effectively prevent expansion of Cayman companies into other jurisdictions or business lines where they have no expertise. CIMA require letters of good standing from the home state supervisor for branches located within the Cayman on an annual basis, together with the accounts for those licensees.
Assessment	Observed.
Comments	No comment
Principle 16.	**Coordination and Cooperation** Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction, either directly or through a separate corporate entity. In order to share relevant information with other insurance supervisors, adequate and effective communication should be developed and maintained. In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor: • is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking, or securities) to share information or otherwise work together; • is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential; • should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and • is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.
Description	The Insurance Division of CIMA had not concluded any MOU's on the exchange of information with other jurisdictions as at the date of the mission, although the authorities informed that two have been concluded in January 2004. The creation of MOU's is governed by MAL s50, which requires the approval of the Governor, notification to the Financial Secretary and publication in the Gazette. Nevertheless, co-operation with other supervisors works informally on a regional and global basis: for example, the head of the Insurance

	Division of CIMA is secretary to the Offshore Group of Insurance Supervisors which exists under the aegis of the IAIS. The basis on which CIMA may exchange information with other supervisors is set out in the Monetary Authority Law s49. One of the essential criteria to this principle states that strict reciprocity with other supervisors is not demanded before exchange of information can take place. However, MAL s49(4)(a) imposes a reciprocity condition, but not strict reciprocity. There is unfettered exchange of information between the supervisors within CIMA.
Assessment	Largely observed.
Comments	This assessment could be improved with an amendment to MAL s49, and the establishment of MOU's with the appropriate jurisdictions.
Principle 17.	**Confidentiality** All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections. The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release. Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.
Description	The Monetary Authority Law s49, contains the confidentiality provisions that apply to directors, officers, employees, agents or advisors of CIMA who disclose information relating to (a) the affairs of the Authority, (b) any application made to the Authority or Government under the laws, (c) the affairs of a licensee, or (d) the affairs of a customer, member, client or policyholder of, or a company or mutual fund managed by, a licensee. Such disclosures are criminal offences and carry the punishment of a fine or imprisonment. The section describes the disclosures that may be made for the legitimate purposes relating to the activities of the Authority, and contains the conditions under which CIMA may exchange information with other Authorities. CIMA staff are subject to confidentiality rules laid out in the CIMA Staff Handbook. It stipulates that confidential information must not be disclosed; outside the Authority, to secure financial advantage, to minimize financial loss or used for a purpose unrelated to the employment. Each employee must sign a declaration of secrecy, which must be resigned each year. The declaration incorporates a condition that any infraction could lead to disciplinary action, immediate dismissal or criminal prosecution.
Assessment	Observed.
Comments	Enforcement actions against companies, pursuant to Insurance Law s5(1)(b) may result in the suspension of a license under s13(1)(i) and such cases must be gazetted under s13(6). Thus, sensitive information which may be in the possession of an Insurance Manager is placed in the public domain to obviate the need to extend confidentiality requirements to persons outside the Authority.

Table 3.4. Summary Observance of IAIS Insurance Core Principles

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	8	2, 3, 5, 10, 11, 14, 15, 17
Largely observed	3	4,12,16
Materially non-observed	6	1, 6, 7, 8, 9, 13
Non-observed	0	
Not applicable	0	

Table 3.5. Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action
Organization of an Insurance Supervisor	
i.e., CP 1	Staffing levels should be increased to supervise the large number of licensees in the jurisdiction (CP1).
Licensing and Changes in Control	
i.e., CPs 2–3	
Corporate Governance and Internal Controls	
i.e., CPs 4–5	Implement a systematic program of risk-based on-site inspections (CP 4). Embody supervisory working practices in law, regulation or rule, as appropriate (CP4).
Prudential Rules	
i.e., CPs 6–10	Consider asset, liability, solvency, and capital adequacy conventions appropriate for the types of company, lines of business, and the nature of the Caymanian insurance sector and embody them in law, regulation or rule as appropriate (CPs 6, 7 and 8).
Market Conduct	
i.e., CP 11	
Monitoring, Inspection, and Sanctions	
i.e., CPs 12–14	Undertake a feasibility study to extend the use of the computerized reporting system, collecting more data and automating more of the analytical processes with the aim of releasing staff resources to more risk-based processes such as focussed on-site inspections (CP 12). Extend reporting requirements so that the full diversity of business underwritten is reported to the authority (CP 12).
Cross-Border Operations, Supervisory Coordination and Cooperation, and Confidentiality	
i.e., CPs 15–17	

Authorities' response

CIMA notes that the IMF mission has assessed insurance regulation against the IAIS 17 Core Principles as "observed" or "largely observed" for 11 Principles and "materially non-observed" for six. The latter assessments are based on either lack of staff or lack of codification of rules or practices. The mission's recommendations are under review or implementation, as set out below, unless otherwise indicated.

CP 1

There were five staff vacancies at the time of the mission visit. Subsequently, two senior analysts and one analyst were hired, and the staffing needs of the Insurance Division are being dealt with at Board level as a priority. It is aimed to implement the agreed HR plan for the Insurance Division in 2005.

CP 4–5

The Insurance Division already has a programme of risk-based on-site inspections in place. At the time of the mission, the programme of full inspections had been suspended because of staff shortages. It resumed in March 2004, and will be enhanced by a revised risk analysis procedure to be implemented for the 2005 timetable for on-site inspections. Focused inspections resumed in November 2003.

The formalisation of supervisory working practices is currently being addressed.

CP 6–10

The mission recommendation is being actively considered, with a view to making recommendations to government regarding changes required to the Insurance Law in early 2005.

CP 12–14

The Operations Division of CIMA has commenced a study of the present IT system and is mapping, on a divisional basis, the necessary upgrades.

IV. Assessment of Anti-Money Laundering and Combating the Financing of Terrorism

A. General

Information and methodology used for the assessment

59. This assessment is based on a review of CI AML/CFT legislation and regulations, as well as nonbinding guidance notes issued by CIMA and industry applicable to institutions regulated by the Proceeds of Criminal Conduct (Money Laundering) Regulations (MLR). The assessment team held discussions with the governor, senior officials from a number of CI government departments and agencies, as well as with representatives of industry. The assessment is based on the information available at the time it was completed on October 9, 2003, and, in a few instances it reflects information submitted after completion of the assessment visit.[5]

Overview of measures to prevent money laundering and terrorism financing

60. Efforts to achieve compliance with international standards have been a top priority in the Cayman Islands in the last few years and there is an intense awareness of AML/CFT in the business community. The Cayman Islands authorities have devoted substantial attention and resources to improving the country's anti-money laundering legal and institutional framework and effective supervision of due diligence requirements since it was identified by the FATF as a non-cooperative country and territory in June 2000. FATF removed the Cayman Islands from the NCCT list in June 2001,after the Cayman Islands enacted comprehensive anti-money laundering measures and took steps to implement the measures. In June 2002, in recognition of the improvements the Cayman Islands had made, FATF ceased its monitoring. Both the authorities and the financial sector continue to take steps to improve the quality of anti-money laundering and combating the financing of terrorism measures to achieve conformity with the FATF 40+8 Recommendations.

61. The legal framework of the Cayman Islands has undergone major revisions and improvements in the past four years. In 2000, the MLR were adopted. In 2001, the Terrorism (United Nations Measures) (Overseas Territories) Order 2001 (TUNMOTO) a U.K. statutory instrument was extended to the Cayman Islands. In 2003, the Terrorism Law (TL) was enacted. With these and other measures, the Cayman Islands now has mandatory suspicious activity reporting, immobilization of bearer shares, regulatory coverage for money service providers, improved gateways for information sharing, clear designations of responsibilities for monitoring AML compliance, enhanced CFT coverage, and other enhancements to the AML/CFT framework. In addition, the Cayman Islands is one of only two jurisdictions reported to have conducted retrospective due diligence on relationships predating September, 2000.

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[5] The team consisted of Ms. Nancy Rawlings (MFD), Ms. Margaret Cotter (Consulting Counsel, LEG), and an independent assessment expert, not under the supervision of the IMF, Ms. Amalin Flanegin, Public Prosecutor, Aruba, Kingdom of the Netherlands, who evaluated the law enforcement sections of the methodology.

62. The MLR apply to financial and non-financial institutions that carry out "relevant financial business" including banking, insurance and trustee businesses, mutual fund administration, company management, currency exchange, money remittance, portfolio management, securities investment, and real estate brokerage. The MLR are supplemented with AML Guidance Notes (GN) issued jointly by CIMA and industry.[6]

63. The institutional arrangements for AML/CFT are fully in place. The relevant institutions include CIMA, which has regulatory and supervisory oversight, the Cayman Island's FIU which has responsibility for receiving, analyzing and disseminating SARs, police authorities who investigate ML and FT crimes and the Attorney General's chambers, which prepares legislation, prosecutes ML and FT, and assists in obtaining production and restraint orders as well in providing assistance to overseas jurisdictions.[7] The coordination between these various institutions is facilitated by the AML Steering Committee. The FIU is being restructured with a former police-type unit being replaced by a largely civilian organization with powers and responsibilities defined in law including an ability to apply for freeze orders and to require supplemental suspicious activity report (SAR) information.

64. ML is criminalized in a manner broadly consistent with the Vienna and Palermo Conventions. The ML offenses extend to proceeds derived from all serious (indictable) offenses, the *mens rea* requirements are knowing, or suspecting or believing, self-laundering is covered and corporate bodies can also be held liable for ML. FT is criminalized in CI by the U.K. Statutory Instrument (TUNMOTO) based on the 1999 UN ICSFT and by the recently enacted TL. However, an Order in Council does not yet extend the application of the International Convention for the Suppression of the Financing of Terrorism (ICSFT) to the Cayman Islands.

65. Laws provide authority for the issuance of orders to confiscate the value of the benefit derived from crimes, including ML and FT. For FT, specific provisions address identification and tracing of criminal proceeds. Civil forfeiture provisions are under consideration.

66. Laws and informal arrangements provide a basis for cooperation in AML/CFT matters. In general the Cayman Islands is able to provide mutual assistance without a treaty relationship (MLAT), but provision of assistance is subject to the principle of reciprocity. Drug trafficking related mutual legal assistance is available under the MDICL and the enforcement of overseas confiscation orders is available under the PCCL. Legislation enacted in January 2004 after the end of the mission extends the MDICL to non-drug trafficking related matters, permits assistance at the investigatory stage, and makes a wider range of assistance available.

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[6] The GN are not relied upon in respect of points of the law; however, they will be taken into account by the courts in determining whether a person has complied with the MLR.

[7] The name of the Cayman Island's financial intelligence unit is the Financial Reporting Unit; however, for the purposes of this report, the acronym, FIU, is used.

67. The United Kingdom's MLAT with the United States was extended to the Cayman Islands by the Mutual Legal Assistance (United States) Law and is a basis for assistance to and from the United States. Incoming mutual assistance requests are channeled through the Attorney General's Chambers (non-U.S. related) or the Chief Justice (US-related), acting in an administrative capacity. Law enforcement assistance from the Cayman Islands can be obtained through the police Interpol channels or informal arrangements.

68. Extradition between the Cayman Islands and Commonwealth countries and other OTs is controlled by the Extradition (Overseas Territories) Order 2002 and various treaties and orders. Under these arrangements, extradition is available for crimes punishable with imprisonment of at least 12 months, including all principal ML and FT offenses. There are also extradition arrangements in place with the United States and a number of European countries.

69. AML/CFT preventive measures are contained in the MLR. The regulations require Cayman Island entities to have procedures about customer identification, employee training, record keeping, and internal reporting of suspicious transactions. Breach of the MLR is a criminal offense. Extensive GN have been issued by the CIMA and the industry. The notes provide appropriate guidance to FSPs regarding customer identification, record keeping, transaction monitoring, suspicious activity detection, reporting, training, compliance, and high risk clients/activities. FSPs have strengthened their internal policies and procedures over the past two years in accordance with the new laws, regulations and GN. Extensive efforts have been made by the FSPs, authorities, and professional associations to train and educate the financial industry in AML/CFT obligations. Many in the industry are active participants in the international AML arena and provide leadership to other jurisdictions.

70. A number of modifications and improvements as set forth in the Detailed Assessment below, should be adopted to strengthen the AML/CFT framework and improve implementation. In a number of instances industry practice in the Cayman Islands already meets the measures recommended for adoption.

Law Enforcement

71. *Various domestic authorities are charged with the enforcement of the AML/CFT legislation: the Attorney General's Chambers, the Royal Cayman Islands Police Force (RCIP) and the FIU are well aware of the legislation. Close working relations appear to exist between all involved. Furthermore a close working relation exists between Customs and the RCIP, of which the Drug Task Force (DTF) is an example. The DTF is comprised of customs and police officers and is in charge of investigations related to drug trafficking. The exchange of information between the local authorities appear to be frequent and without problems. The FIU has direct access to several databases through the Joint Intelligence Unit (JIU), constituting a very useful tool for the analysis of SARs. The role of the JIU is to provide an intelligence data collection, storage and retrieval for all CI law enforcement agencies and is the link between the FIU and the RCIP Financial Crime Unit. Exchange of SAR related information with foreign FIUs is only possible with the prior approval of the Attorney General's Chambers. According to the latest amendments to the PCCL the director of the FIU may enter into arrangements with foreign FIUs only with*

the prior consent of the AML Steering Group. In both cases the requirement of prior consent or approval might delay the exchange of information between CI's FIU and overseas FIUs.

72. *The authorities have sufficient manpower and knowledge to execute their tasks. The officers met seemed to be motivated and receive on a regular basis special trainings provided by international and regional organizations. With assent by the Governor to the latest Bill amending PCCL, the FIU will need more staff members, e.g., analysts.*

73. *The FIU is well equipped and has modern accommodation. Customs has only one vessel to do patrols, hampering an increase of the amount of searches and patrols.*

74. *Feedback is given to reporting entities by the FIU. The FIU should continue to provide information based on the latest trend and typologies discovered in SARs to the reporting authorities on a regular basis.*

B. Detailed Assessment

75. The following detailed assessment was conducted using the October 11, 2002 version of *Methodology for assessing compliance with the AML/CFT international standard, i.e.,, criteria issued by the Financial Action Task Force (FATF) 40+8 Recommendations* (the Methodology). For the most part, it is based upon the status on October 9, 2003, the final day of the mission.

Assessing criminal justice measures and international cooperation

Table 4.1. Detailed Assessment of Criminal Justice Measures and International Cooperation

I—Criminalization of ML and FT (compliance with criteria 1-6)
Description
In general, CI law provides the necessary legal framework to comply with criteria 1–6 as it relates to ML and FT. UN Resolution 1373 was implemented in October 2001 through TUNMOTO. An additional measure, the new TL criminalizes FT in a more detailed and comprehensive manner. The Vienna Convention has been extended to CI as of February 1995, and is implemented through several laws including the MDL. The Palermo Convention has not been ratified by the United Kingdom and accordingly has not been extended to CI. CI being an Overseas Territory of the United Kingdom, it cannot directly ratify international treaties, but the U.K. can extend their application to CI by Order in Council. Extension of U.K. treaty obligations to CI depends to some extent on its ability to implement them through domestic legislation. The ICSFT has also not yet been extended to CI, although its provisions are implemented by TUNMOTO and the TL. **ML** has been criminalized as follows: • Drug trafficking ML is criminalized under Sections 47 and 48 of the MDL which set forth offences for facilitating the retention and control of drug trafficking proceeds and concealing, disguising or transferring the proceeds of drug trafficking. • ML for other crimes is criminalized by Sections 22–25 of the PCCL, and covers facilitating the retention and control of proceeds; entering into arrangements such that proceeds are used to secure funds or acquire property; acquisition, use or possession knowing property is proceeds; concealing,

disguising, converting or transferring to avoid prosecution or the making of a confiscation order and concealing or disguising to assist another to avoid prosecution or the making of a confiscation order.

Drug trafficking ML is covered by the MDL. Under Section 5(7)(c) of the PCCL, ML extends to all offenses other than drug offenses that may be proceeded with by indictment. This would include the offenses (which are limited to listed persons) set forth in Al Qa'ida and Taliban (United Nations Measures) (Overseas Territories) Order 2002 and to the broader offenses listed in TUNMOTO, as well as terrorism and FT offenses set forth in the TL. Under Section 22(10) of the PCCL, extraterritorial crimes may serve as predicate offenses for ML occurring under that Act, as conduct that would constitute an offense had it occurred in CI is set forth as criminal conduct under the Law. Under the MDL, drug trafficking and drug trafficking ML extend to extraterritorial acts. Section 2(1), MDL.

The CI introduced "all crimes" anti-money laundering legislation through the PCCL, which was brought into force in 1996. The PCCL created four ML offenses, (i) assisting another to retain the benefit of criminal conduct (section 22); (ii) acquisition, possession or use of property representing the proceeds of criminal conduct (section 23(1)); (iii) concealing or transferring proceeds of criminal conduct (section 24); and (iv) tipping off (section 25). The ML provisions in the PCCL apply to criminal conduct, which is defined as an indictable offense in the CI other than drug trafficking offenses or conduct taking place overseas that would constitute such an offense if it had occurred in CI.

Unlike the PCCL, the MDL does not include an offence relating to possession and use of proceeds, although knowing acquisition without consideration or inadequate consideration is prohibited. MDL, Section 48(3).

The ML offenses extend to any type of property that directly or indirectly represents the proceeds of crime. MDL, Sections 47(2), 48(1), 48(2), 48(3); PCCL Sections 22(2), 23(1), 24(1), 24(2). Under both the PCCL and MDL, ML applies both to those who have committed ML only and to those who have committed both laundering and the predicate offense.

Authorities have indicated that under criminal ML provisions in CI, it is not necessary for a person to be convicted of the predicate offence to establish assets were proceeds of the predicate offence and convict the person. However, there must be evidence that a crime was committed and that the proceeds were connected to the offence. Under a recent court ruling, there must be sufficient evidence before the court that it would be "bound to conclude" that funds were proceeds. CI's evidentiary laws make clear, on the other hand, that a conviction is evidence of the commission of a predicate offence.

Separate from the criminal statutes, the MLR impose criminal liability on relevant financial businesses (including regulated financial institutions) that fail to establish and maintain certain anti-ML procedures and provide training. For the purposes of the MLR, ML is defined by making a cross-reference to the offences set forth in the PCCL and the MDL: "money laundering" is doing any act which constitutes an offence under sections 47–48 of the MDL or section 21–23 of the PCCL, or doing, outside of the Islands, any act which would constitute an offence under these provisions if done in the Islands. As the separate ML offence for FT is established in the TL, the ML definition should be extended, so the MLR are clearly applicable in this setting.

Financing of Terrorism. The financing of terrorism was criminalized by TUNMOTO in 2001, on the basis of the ICSFT. Section 3 (Collection of Funds) criminalizes the act of providing money or other property with knowledge or intent they will or may be used for the purposes of terrorism (sub paragraph 3) and fund-raising activity for the same purpose (sub paragraph 1). Section 4 (Making Funds Available) further extends criminal liability to making any funds or financial services available for the benefit of persons committing facilitating an act of terrorism. For the purpose of TUNMOTO, "terrorism" is defined by Section 2 as: 1) the use or threat of "action" that involves serious violence against a person, serious damage to property, endangers another person's life, creates a serious risk to the health or safety of the public, or a section of the public, or is designed seriously to interfere with or seriously to disrupt an electronic system, and 2) that use or threat of action is designed to influence the government or intimidate the public or a section of the public and made for the purpose of advancing a political, religious or ideological cause. A generic harm, damage or risk-based definition is used, which seems to capture all acts defined by relevant treaties. Section 2 clarifies that "action" includes action outside the territory of the CI, and that the "person," "property," and "public" involved may also be overseas.

TUNMOTO does not explicitly criminalize the financing of terrorists or terrorist organizations. For ancillary offences such as attempt or participation in FT offences The Penal Code (1995 Revision) applies. See section 18 and 303. In addition, Section 49 of the Interpretation Law provides that provisions setting forth offences are deemed to cover attempts unless a contrary intention appears.

The definition of "terrorism" as explained above may cover actions by both individuals and organizations and the "threat of action" under Section 2 could be considered as an attempt.

CI has criminalized FT in a more detailed and comprehensive manner in the recently enacted TL. Section 20 (Use and Possession) of the TL extends criminal liability to the use of money or property for the purposes of terrorism as well as to their possession if the perpetrator intends or has reasonable cause to suspect that they may be used for such purpose. It also contains a separate money laundering provision (Section 22) that prohibits entering into or becoming concerned in an arrangement which facilitates another's retention or control of terrorist property.

Offences of ML and FT apply to both persons and entities that knowingly engage in ML/FT activity. According to the authorities, in the CI courts, the intentional element of ML and FT may be inferred from the objective factual circumstances. In the totality of the evidence submitted to the court, objective factual circumstances can support a conclusion regarding intent. No law specifically addresses this. The offences of ML and the FT extend to all entities. Under CI law, legal entities have criminal liability. The Interpretation Law Section 3 states that "person" includes corporations, clubs, societies, associations or other bodies of one of more persons. Under Section 11(4) of TUNMOTO, both a body corporate and any officer who consented or was neglectful is liable for an offence.

The criminal offences of ML are subject to adequate penalties ranging from fines to 14 years of imprisonment. If the prosecution proceeds on indictment, the fine imposed by the court may be any amount the court determines. The criminal offenses for FT are also subject to adequate penalties ranging from seven years and fines under TUNMOTO to 14 years and fines under TL. The penalties under the MLR at Section 5(2) for regulatory offenses are a fine of fine of five thousand dollars on summary conviction and imprisonment and a fine (determined by the court) if there is conviction after an indictment. There is a ladder of regulatory sanctions available as well through the action of the supervisory authorities including revocation of license, although administrative fines are not currently available as CIMA has not issued rules. (See, Table 2, Section VIII.)

Legal means and resources are adequate to enable an effective implementation of ML and FT Laws. The authorities in charge with the implementation are:

The Financial Reporting Unit (FRU), appointed by the Governor under section 21 of the PCCL as the Reporting Authority, is currently staffed by a Director and six officers from the RCIP: two detective inspectors, one detective sergeant and three detective constables. Furthermore, the FRU has sufficient computer resources. The FRU receives SARs and investigates or onwardly discloses to foreign investigative agencies where necessary. Any disclosures of SARs outside CI need the Attorney General's approval according to PCCL, which can be received in a very short period of time (standing protocol provides for a 24-hour turn-around). Under the current structure, the FRU also prepares and submits files to the Attorney General's Chambers for ruling and prosecution where appropriate.

In the new structure, the RCIP Financial Crime Unit will be in charge of investigations of all financial crime including those investigations triggered by SARs and not the new FIU. The Financial Crime Unit, which will be housed in the same accommodations where the FRU is currently housed, will consist of one detective superintendent, two chief inspectors, three inspectors, five detective sergeants and ten detective constables.

In general, the investigation of criminal matters, including money laundering investigations, is undertaken by the RCIP (total amount of officers 322). They prepare the files and submit these to the Attorney General's Chambers for ruling and prosecution where appropriate.

The Attorney General's Chambers has a staff complement of six Crown Counsel (criminal). Case Controllers are appointed for large money laundering prosecutions when necessary.

On the job training has been provided to two prosecutors and further training is scheduled for October 5–11, 2003 in Trinidad and Tobago, organized by the Caribbean anti-money laundering programme (CALP). Two prosecutors will be attending.

The Terrorism Law 2003 introduces the obligation to disclose information concerning terrorism and terrorist financing to the FIU.

Analysis of Effectiveness

The mission considers that although ML is criminalized broadly in accordance with the Vienna Convention, given the complexity of the various ML provisions and lack of consolidation, there are issues of consistency, which the authorities recognize. The PCCL contains a broad provision criminalizing acquisition, possession and use of another's proceeds; the MDL has a more limited provision regarding acquisition without consideration or inadequate consideration. In addition, purpose to avoid prosecution or confiscation appears in both the MDL (Sections 48–1, 48–2) and PCCL (Sections 24–1, 24–2) but not in the TL (Section 22). The mission considers that this requirement adds to the complexity of the offense and creates an additional burden on the prosecution. Purpose to avoid prosecution is possible under the Vienna Convention but only in a significantly more limited setting. Specifically, under the Convention, it applies only for third party liability, and as one of two possible purposes. The conversion or transfer of property known to be proceeds should be criminalized in two situations: where the purpose of the transfer is to conceal or disguise the illicit origin of the property or where the purpose of the transfer is to assist a person involved in the commission of the offense to evade the legal consequences of his action. Section (3)(1)(b)(i).The CI criminal provisions make purpose to avoid prosecution applicable more broadly and thus may make proof more difficult in some settings.

The Palermo Convention has not yet been ratified by the U.K. so its application has not been extended to CI.

The U.K. enacted a new Proceeds of Crime Act (PCA) which among other things provides for a single set of money laundering offenses in one Act. Authorities in CI are currently considering this and other provisions of the U.K. PCA for adoption into CI law, and are planning a consolidated approach to the criminal ML offenses. A single comprehensive set of provisions would simplify the complex approach set forth currently in CI laws, and ensure that all conduct that should be criminalized is covered for all offenses.

While it is not necessary that some person be convicted of the predicate offence to establish that assets were proceeds of the predicate offence, under current judicial precedent the level of evidence necessary to establish a crime was committed and that proceeds were connected to the offence is quite high: there must be evidence such that the court would be "bound" to conclude that funds were proceeds. This may well have the effect of necessitating the presentation of nearly the entire criminal case against the predicate offence offender. This poses difficulties particularly since in the CI context, often the predicate offence has occurred overseas.

For FT, the CI has adopted measures to implement UN resolutions, and has passed a TL that criminalizes the FT to supplement the current TUNMOTO which also has provisions criminalizing the FT. These provisions criminalize the financing of terrorism on the basis of the ICSFT Convention. The ICSFT has not yet been extended to the CI.

Offenses of ML and FT apply to persons who knowingly engage in activities and the intent element may be inferred from objective circumstances.

Because of the restructuring of the framework of the FIU, a separation will be introduced between the roles of SAR handling and investigation with a view to prosecution. The IAE concludes that the new framework will support effective operations regarding SAR handling by the new FIU and investigation by the Financial Crime Unit, and at the same time will provide a clear separation of duties between the entities involved, protecting the confidentiality of the information received from the reporting entities.

Recommendations and Comments
• Ensure that following the ratification of the Palermo Convention by the U.K., its application is extended to the CI within a reasonable timeframe. • Have the ICSFT extended to CI. • Harmonize ML offenses with one another and expand the MDL's limited provision regarding acquisition of laundered property. • Update the definition of ML in the MLR to include references to the FT money laundering offense. • Consider addressing through legislation the evidentiary burden for establishing funds are proceeds (which does not require the prosecution to, in essence, prove the predicate offense. • *Fill vacancies at the new FIU as soon as possible to enable it to fulfil its duties.*
Implications for compliance with FATF Recommendations 1, 4, 5, SR I, SR II
1: Compliant 4: Compliant 5:Compliant SRI: Compliant SRII: Compliant
II—Confiscation of proceeds of crime or property used to finance terrorism (compliance with criteria 7-16)
Description
CI confiscation regime is mainly regulated through the PCCL and MDL, and in general constitutes a sound basis for recovering criminal proceeds from any criminal conduct. The MDL enables confiscation with regard to drug proceeds and the PCCL for all other indictable crimes. The TL provides explicitly for confiscation relating to FT offenses, and the PCCL is available currently. Confiscation is conviction based under the PCCL and MDL. It is clearly mandatory under the MDL and while it appears permissive under the language of the PCCL, authorities indicate in practice courts always consider all the factors under the PCCL to determine whether there are proceeds to be confiscated. Courts first have to determine whether the defendant has benefited from his/her crime, and if so can order the payment of a sum equivalent to that benefit. Specifically, the MDL (Sections 30–37) enables the court to confiscate the proceeds of drug trafficking. Confiscation must be applied if the court determines that the person benefited from drug trafficking, i.e., "received any payment or reward in connection with drug trafficking" (Section 31(3), MDL) and decides on the amount to be recovered, which it will order the defendant to pay. The court is to order any monies or any other thing that relates to or has been acquired due to or as a result of the offence is to be forfeited (Section 30(1), MDL), and the amount to be recovered is the amount the court assesses to be the value of the defendant's proceeds of drug trafficking. (Section 35(1), MDL). In assessing this amount, any payments or other rewards received in connection with the drug trafficking offense are considered proceeds. (Section 33(4), MDL). In its determination, the court uses the standard of proof applied in civil proceedings and may rely on assumptions. For example, in determining the amount to be recovered, the court may assume that any property in the defendant's possession is proceeds. These assumptions can be rebutted by the defendant. Proceeds of criminal conduct are defined as "the benefit" from criminal conduct. (Section 31(1), MDL). The payment of the amount is enforced as if it were a fine, including the possibility of imprisonment in the case of default. As under the MDL (Section 2), "drug trafficking offenses" include the ML offenses defined at sections 47–48 of MDL, confiscation powers conferred upon the courts extend to defendants accused of drug ML. The PCCL applies to all crimes other than drug trafficking with a penalty of 2 years imprisonment or more. Its provisions are available for underlying criminal conduct that is terrorist related, and its confiscation provisions would be used. FT offenses of TUNMOTO as well as the offenses in the TL (Section 5) are subject to confiscation under the PCCL. For its part, the PCCL (Sections 5–19) provides that the court has the power to require payment if a defendant has benefited from an offense to which the law applies. The amount confiscated is the value of the property obtained as a result of or in connection with the offense, including pecuniary advantages. Where a person derives

a pecuniary advantage as a result of or in connection with the commission of an offense, he is to be treated for the purposes of the PCCL as if he had obtained as a result of or in connection with the commission of the offense a sum of money equal to the value of the pecuniary advantage. Under the PCCL, property to be confiscated need not be the specific laundered funds or proceeds, but may be any property of the defendant. Proceeds a defendant has secreted with others may be reached.

The CI confiscation regime is therefore in general value-based and does not deal with the confiscation of laundered property, or of instrumentalities used in or intended to be used for a money laundering offense. A CI confiscation order is a value order that makes no link between an asset subject to confiscation and its availability or otherwise. As such a confiscation order can be enforced against any kind of property, regardless of whether it has been legally or illegally obtained. Instrumentalities are addressed by a general provision, Section 190 of the PC. Instrumentalities may be seized, and the court may direct that they be kept or sold, and revert to the State if within a 12 month period no person establishes a right to such property to the satisfaction of the court. Section 190, CPC.

As seen, at present criminal confiscation and forfeiture generally dependent upon conviction in CI but there are plans to introduce legislation similar to the U.K. Proceeds of Crime Act 2002 which provides for a nonconviction based civil procedure permitting the recovery of criminal assets. However, the current legislation allows civil forfeiture in several situations: under Section 26(1) of MDL, a constable or customs officer may seize and detain cash, which directly or indirectly represents a person's proceeds of drug trafficking, and under Section 27(1) a magistrate may order a forfeiture of this cash. The applicable standard of proof is that applicable in civil proceedings. Under Section 31 of the Penal Code, forfeiture is available in cases of official corruption. In addition, Section 190 of the CPC has made recovery of proceeds without conviction available in some circumstances. Under that provision, a court may order the seizure of property where there is reason to believe it has been obtained by, or is the proceeds or part of the proceeds of, an offense. If no one establishes a right to the property within twelve months, it reverts to the state.

Restraint orders and seizure of cash are also available. The MDL (Section 26) provides that the police may seize cash if it is believed to be drug trafficking proceeds or intended for drug trafficking. On application by a prosecutor, if necessary made *ex parte*, courts can order the restraint of property under the MDL and the PCCL. These orders prohibit dealing with any realizable property held by any person and enable the provisional freezing or seizure of money or property liable to confiscation. Seized property subject to a restraint order may be managed by a receiver. For restraint orders under the PCCL, charges must be lodged within 21 days (Section 9(2), PCCL) and for drug offenses, the charges must be forthcoming within a reasonable period. For FT, there is a specific provision regarding freezing of FT funds.

There is no specific provision in CI law authorizing the freezing or confiscation of assets of organizations that are found to be primarily criminal in nature. However, the law of the CI is in general directed at "persons," which includes legal entities, and once prosecuted and convicted, CI confiscation provisions are applicable to legal entities, whether criminal in nature or not.

CI does not have separate legal provisions addressing identification and tracing powers for crimes set forth under the PCCL or MDL. Under the PCCL and MDL, the police may obtain production orders, but neither provides for customer identification or account monitoring orders for the purpose of investigations into ML or for tracing assets, although the TL contains such provisions applicable in FT matters. Under the PCCL (Sections 29), the police may apply, also *ex parte*, to a judge for an order "to make material available" (i.e., a production/disclosure order) in order to determine whether someone benefited from crime or the extent and whereabouts of the proceeds. This order is issued to the person (including a corporate person) in possession of the material and it either compels the person to hand it over to the police or to give access to it. The conditions include that the material is likely to be of substantial value to the investigation and that there is no legal privilege that applies to it. Once granted, access to the material includes the possibility of entering the premises where the material is held or obtaining the production of the material in a visible and legible form if it concerns computer data. Whereas the information cannot be disclosed if it is protected by legal privilege, secrecy or other restrictions, these are waived by the this production/disclosure order. Legal privileges include the attorney-client privilege, which covers communications made in connection with the giving of legal advice or in view of legal proceedings. The PCCL also provides (Section 30) for search warrants to determine, as productions orders, whether someone benefited from crime or the extent and whereabouts of the proceeds. The police may obtain a search warrant from a judge, if the production/disclosure order under section 29 has not been complied with or is

inappropriate under the circumstances, there are reasonable grounds for suspecting that a specified person has benefited from a crime, the material is likely to be of substantial value to the investigation and that there is no legal privilege that applies to it. Under the MDL (Sections 44–45), similar provisions are made for the issuance of an order to "make material available" (i.e., a production/disclosure order) for investigations into drug trafficking offenses and for subsequent searches.

The PCCL allows any person affected by the making of a restraint order to apply to the issuing court for the order to be varied or discharged. (Section 10(7)). Under section 12(8) of the PCCL, the court before realising any property subject to confiscation, is to give reasonable opportunity to persons holding an interest in such property to make representations to the court. Section 14(4) of the PCCL also provides that the powers of the court relating to restraint, charging orders and realization of property are to be exercised with a view to allowing persons other than the defendant or recipient of gifts from the defendant to retain or recover the value of any property held by him. These provisions are to ensure that innocent persons or bona fide third parties may state their interest in restrained property before confiscation. The MDL provides for notice to persons affected by a restraint order and for a reasonable opportunity for persons holding interests in property to make representations regarding it before orders are entered. Section 39(3)(c) and 40(7), MDL. The TL at Section 28(7) provides for owners or persons with an interest an opportunity to be heard, and Schedule 3, Section 5 provides for notice to and hearing of persons affected by restraint orders.

With respect to provisions that allow for the possibility of voiding contracts that aim to frustrate confiscation orders, Section 14(6) of the PCCL provides that in exercising its powers of restraining and realizing property pursuant to a confiscation order, the Court shall take no account of any obligations of the defendant or of the recipient of any such gift which conflicts with the obligations to satisfy the confiscation order.

By Section 5 of TUNMOTO, where the Governor has reasonable grounds for suspecting that the person by, for or on behalf of whom any funds are held is or may be a person who commits, attempts to commit, facilitates or participates in the commission of acts of terrorism, or is controlled directly or indirectly by, or acting on behalf of such a person, he may by notice direct that those funds are not to be made available to any person except under the authority of a license granted by him. Names need not appear on a UN list for such freezing to occur. The TL provides for restraint orders prohibiting dealing with any property that could be forfeited including property the offender had reasonable cause to suspect might be used for the purposes of terrorism. Schedule 3, Section 5, TL.

While the mission understands that the CI is able to restrain (freeze) terrorist funds or other property under the TL, it is unclear to what extent funds or property belonging to those who finance terrorism or to "terrorist organizations" can be seized or restrained. The TL refers (Section 5) to the restraint from dealing in property as to which a forfeiture order could be made. Forfeiture for soliciting terrorist property extends to property in the offender's possession and control at the time of the offense and which he knew or had reasonable cause to suspect would or might be used for the purposes of terrorism. The mission is uncertain whether the property of a person or of an organization that finances terrorism or is a terrorist organization as such, property other than which is likely to be used for the purposes of terrorism, can be restrained or frozen. It appears to the mission that the language of the TL and TUNMOTO may not permit such general restraint on the property of terrorist financiers or terrorist organizations.

While there is no formal asset forfeiture fund, seized funds are paid into general revenue for accounting purposes, but are then segregated internally by the Treasury to be applied to AML and anti-narcotics purposes. Since 1992, all funds have been dedicated to AML and anti-narcotics purposes, with the court, the Attorney General and Chief Officer of Finance making recommendations to the Cabinet regarding the application of such funds. Authorities do not believe a formal asset forfeiture fund is necessary or that its attendant costs could be justified given the current volume/monetary amounts.

There are asset sharing agreements in place between CI and the United States, and a UK agreement extended to CI applicable for sharing with Canada. Asset sharing occurs on a regular basis.

Confiscation records are kept by the authorities.

Statistical information was provided by AG's Chambers indicating that the restraint provisions under the PCCL were used 22 times since 1997, frequently in cooperation with overseas law enforcement authorities resulting in

the confiscation of cash and real estate.

RCIP provided figures showing for 2002 a total of detected criminal offences of 2140. Of this total, 458 were offences related to the Misuse of Drugs Law involving cannabis and 293 offences involved cocaine.

The Drugs Task Force (comprised of 23 officers of RCIP and Customs), seized in 2002 cannabis and cocaine in the amounts of 6,681 kg and 410.6 kg, respectively. The marine and land based units have also seized assets in connection with drugs trafficking, such as, canoes and cars.

The Customs Narcotics Enforcement Team seized from January 1, 1996 till December 31, 2002, besides five vessels and six vehicles, several types of drug, including cocaine (3,988.50 pounds) and cannabis (1,0793.51 pounds).

Training, in house or externally, is being provided to prosecutors and magistrates. In house training is also provided to RCIP and Customs officers at e.g., the Regional Drug Training Center in Jamaica.

There is legal authority to freeze property in connection with terrorist financing but this has not been required to be used yet.

Analysis of Effectiveness

The confiscation and provisional measures provisions in CI are similar to those found in some other common law jurisdictions, and are quite comprehensive. Generally a conviction must be obtained in order for confiscation to occur, although the CPC Section 190 has provided an alternative in cases where a defendant has passed away or absconded, and in other circumstances. Confiscation orders are value based. All benefits derived from criminal conduct, including income earned on proceeds, are subject to confiscation. Confiscation is clearly mandatory for drug trafficking but for other crimes could be viewed as permissive although authorities note the practice is that confiscation is considered and ordered to the extent assets are available in every case.

The confiscation scheme addresses criminal proceeds but does not address laundered property separately and directly. As laundered property in some settings is not the proceeds of offense under investigation/prosecution, provision should be made for the confiscation of such property.

CI has not enacted specific provisions relating to identification and tracing. The mission considers that the PCCL and MLR's general confiscation regimes should be supplemented with full powers to enable the timely identification and tracing of criminal proceeds liable to confiscation. The compulsory powers currently available to CI law enforcement authorities (disclosure/production orders, search warrants) are designed more to procure disclosure of written records rather than to follow in a swift and efficient fashion the money trail.

CI has not adopted special provisions that provide for automatic confiscation of the assets of companies that are established solely for criminal purposes, and might consider such provisions to supplement the normal confiscation provisions that apply to both persons and legal entities. The PCCL and MDL have provisions for the protection of third party rights.

While the confiscation scheme is extensive, a review and updating of the current overall scheme, as is occurring, in light of recent developments in other countries (for instance, in light of the UK's recent Proceeds of Crime and Regulation of Investigatory Powers Acts) and evolving concepts, would improve CI's ability to address proceeds of crime. In this regard, among other things, consideration should be given to a forfeiture scheme based upon civil law, specific provisions addressing identification and tracing, measures that ensure restraints are always available at early stages of an investigation and that third party rights are fully protected for drug trafficking money laundering.

CI authorities keep extensive records of the amount of money and cases based on PCCL restraints, detected criminal offences, seized assets, and confiscated drugs. The FIU should keep specific records of the SARs used in police investigations and prosecutions.

Recommendations and Comments
• Ensure that under the PCCL courts must always consider whether proceeds exist, and confiscate proceeds. • Amend the PCCL to provide specifically for the confiscation of laundered property. • Amend the PCCL to provide for a range of powers enabling tracing of proceeds including account monitoring orders, as is currently under consideration (Model could be U.K.'s Regulation of Investigatory Powers Act 2001. • Consider a civil forfeiture scheme based on the U.K. Proceeds of Crime Act 2002 to recover assets derived from any unlawful conduct in a non-conviction based procedure subject to ensuring protection of legitimate rights to property. • Review FT laws to ensure there a full ability to restrain the property of terrorist organizations and persons who finance terrorism. • *Keep specific records of the SARs used in police investigations and prosecutions.* • *Provide training on the newest trends and typologies discovered by the FIU from SARs on a more regular basis.*
Implications for compliance with FATF Recommendations 7, 38, SR III
7: Largely compliant (confiscation not mandatory; need provision for confiscation of laundered property, specific statistics not available of SARs used in police investigation and prosecutions) 38: Largely compliant (range of tracing powers) SRIII: Largely compliant (questions on ability restrain certain property of terrorist financiers and terrorist organizations)
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels (compliance with criteria 17-24)
Description
CI has had an FIU, the FRU, since 1989. In 2001, CI's FIU became a member of the Egmont Group. In October 2003, the PCCL was amended (amendments assented to post-mission) to make significant changes in the structure of the FIU including moving from a police type FIU to one largely administrative/civilian and to provide it with specified powers. Section 21 of the PCCL, which had provided for the issuance of directions by the Governor to the Reporting Authority (the FRU) as to its powers and duties, was replaced with the formal establishment of the Financial Reporting Authority (FRA), with a Director, an attorney, and accountant and such other persons as necessary. These individuals are to be appointed by the Governor after consultation with the AML Steering Group, chaired by the Attorney General and consisting of senior law enforcement officials as well as the managing director of CIMA and the Financial Secretary. The FRA is responsible for, among other things, receiving, analyzing and disseminating disclosures of financial information regarding proceeds or suspected proceeds, including those relating to terrorism or the FT. (Section 21A, PCCL Amendment 2003). The new structure and powers are addressed here in most instances rather than the structure at the time of the mission. With some exceptions, the FIU powers are the same; PCCL Amendment 2003 merely sets them forth explicitly. The new FIU, the FRA, is to receive all domestic disclosures of information regarding proceeds of crime (including specifically ML and FT) notwithstanding other provisions of CI law which currently provide in some instances for reporting to a constable, and is also to receive all disclosures of information from other FIUs. (Section 21A, PCCL Amendment 2003. The FRA is empowered upon receipt of a disclosure to apply to the Grand Court for an order for a freezing of a bank account for a 21 day period. Under Section 27 of the PCCL, there is required reporting to the FIU. Under that section, if a person knows or suspects another is engaged in ML, and the information came to him/her in the course of trade, profession, business or employment, it is an offense if the information is not disclosed to the FIU as soon as is reasonably practicable. Under other laws, it is also an offense to fail to report transactions suspected of being used to finance terrorism. Section 8, TUNMOTO, Sections 25, 26, and Schedule 1, TL. For drug offenses, there is no affirmative failure to report criminal provision, but reporting is a defence to being liable for the offenses of assisting drug traffickers. (Section 47, MDL.) Though MDL provides disclosures for drug trafficking offenses are to be made to constables of the rank of Inspector or above and the FT laws provide for disclosures to the FIU (as Reporting Authority) or a constable, or to the Governor, the PCCL Amendment

2003 provides the FIU (as Reporting Authority) shall receive all such disclosures. Section 21A(10).

Under the PCCL, reporting parties are required to submit suspicious reports where the party knows or suspects that a person is engaged in ML. In the case of FT as it relates to the regulated sector and public sector, reporting is required if one knows or suspect or has reasonable grounds for knowing or suspecting the FT. (Schedule 1, Section 1, TL). In the case of drug ML, disclosures of a "suspicion or belief" relieve the disclosing party of criminal liability. (Section 47 (3), MDL.)

The CIMA has issued GN that include sections on the identification of complex and unusual transactions. CIMA is authorized specifically to issue and amend rules, statements of principle and guidance to reduce the risk of financial service businesses being used for ML or other criminal purposes. Section 34(1)(c), MAL. The FIU has assisted CIMA in preparing the Notes as they relate to the identification of such transactions, although there is no formal guidance specifically addressed to the identification of FT transactions. The GN provide examples of suspicious transactions. Schedule K, GN.

The GN provide that if a MLRO decides information substantiates a suspicion of ML, the information must be disclosed promptly to the FIU (Section 5.24, GN), and a report, preferably in the standard form as attached to the GN should be sent to the reporting authority, with urgent matters by telephone or email. (Sections 5.28–29, GN). There is no requirement in law that a standard form of SAR be used. Section 21L of PCCL Amendment 2003 provides that the FIU may, with the approval of the AML Steering Group, issue guidelines setting out forms and procedures for making a report of suspicious transactions.

The FIU has the authority under the PCCL Amendment 2003 to require any person to provide information for the purpose of clarifying or amplifying information disclosed to it. Section 21A(2)(c). Currently such information is available through additional supplementary SAR disclosures and through voluntary disclosures with protection under the CRPL. If the requisite information is not forthcoming, the FIU may seek a production order.

The FIU has access to a wide range of financial, administrative and law enforcement information. Under the structure expected to be in place before the end of 2003, there will be a law enforcement officer who is part of a law enforcement Joint Intelligence Unit (JIU) who is assigned liaison officer to the FIU who will have full access to all police information and data bases and will assist in analyzing SARs. Real time searches are and will continue to be possible on the Customs and Police databases by virtue of the fact that the FIU is a law enforcement agency. Immigration information is also available. The FIU also has access to records such as vehicle registration, company records, court judgments, passport, land and property title documents, and records from other government departments. The FIU also has access to commercial databases. In addition, the FIU liaises with CIMA in order to obtain appropriate regulatory agency information. Under Section 49(2)(a) and (g) of MAL, disclosures are through CIMA's filing of a SAR or through a production order.

Although the FIU is not authorized by law to order sanctions or penalties for failure to comply with reporting obligations, CIMA may take administrative actions against entities it regulates, including license revocation but not currently including administrative fines. Its powers to fine are dependent upon issuance of rules not yet issued or planned, and any fine is limited to $1000. With respect to criminal sanctions, failure to disclose knowledge or suspicion of ML for offenses under the PCCL is punishable upon conviction after indictment with up to two years imprisonment and/ or a fine (unlimited) and upon summary conviction of a fine of up to $50,000. (Section 27(10), PCCL). Failure to disclose knowledge or suspicion of FT crimes is punishable on conviction after indictment with imprisonment of up to five years and a fine (unlimited) and upon summary conviction to imprisonment for six month and a fine of $4,000. Schedule 1, Section 1(13). There is no similar offense in the case of drug ML.

The FIU is authorized to disseminate financial information and intelligence to domestic law enforcement authorities where there is prima-facie evidence of criminal conduct or where the FIU has cause to suspect criminal conduct. Section 22 (8)(a) and 23(9)(a), PCCL Amendments 2003. It may disclose information received relating to criminal conduct to CIMA, or other institutions or persons as designated in writing by the Steering Committee. (Sections 22(8)(b) and 22(9)(a). It has the authority currently as well to make such disseminations. The FIU routinely disseminates intelligence to various agencies within CI for the purposes of the investigation of crime.

The FIU is authorized to share financial information, either on its own initiative or upon request, outside the CI with respect to conduct (which constitutes an offence to which the Law applies or would constitute such an offence if it had occurred in CI other than drug trafficking offences) with any financial intelligence unit in any other country. For disclosures of SARs themselves, although the decision is the FIU's, the Attorney General must provide consent. (PCCL, Sections 22(6) and 22(8)(c), and Sections 23(7) and 23(9)(c). The FIU primarily exchanges intelligence with other FIUs within the Egmont Group. Although MOUs are not necessary for sharing information, the FIU may enter into such agreements with the consent of the Steering Group, if the Director of the FIU considers it necessary or desirable for the discharge of functions. Accordingly, should a foreign FIU need such a MOU, there is a legal basis for such MOUs. The provisions of the PCCL which relate to disclosures to overseas authorities appear to relate only to non-drug trafficking matters as Schedule 3(1)(b) of the PCCL excludes drug trafficking.

For information disclosed outside of the CI, the Attorney General imposes conditions which set forth adequate safeguards to protect the information. PCCL, Sections 22 (6) and 23 (7).

The FIU keeps statistics. The following figures were provided relating to SARs:

SARs filings (January 1, 2002 up to September 29, 2003)

Year	*Banks & trusts*	*CIMA*	*CSPs*	*Law firms*	*Money trans-mittors*	*Accoun-tants*	*Secur-ities*	*Real-tors*	*Insu-rance*	*CSX*	*others*	*total*
2002	*257*	*35*	*38*	*46*	*6*	*18*	*10*	*8*	*8*	*0*	*17*	*433*
To 9/29/03	*144*	*27*	*19*	*20*	*5*	*5*	*4*	*1*	*0*	*1*	*1*	*227*

FRU Onward disclosures (OD) by main recipient, and requests (RQ) (January 2002 to September 29, 2003).

Year	*Fin-CEN*	*FBI*	*SEC*	*CIMA*	*RCMPs*	*DEA*	*TFOs**	*US Customs*	*RCIP*	*Misc OD*	*LRQ (a)*	*FRQ (b)*	*Total*
2002	*38*	*19*	*12*	*8*	*4*		*5*			*75*	*143*	*60*	*161*
To 9/29/03	*9*	*6*	*19*	*5*	*5*	*4*	*4*	*8*	*25*	*22*	*52*	*16*	*83*

** Terrorist Financing Operation Section: (a) requests to overseas agencies as a result of SARs: (b) requests from overseas agencies as a result of SARs.*

Overseas (informal) requests not relating to SAR's- 2002: 60; 2003: 89

Offences identified from SAR's 2002 and 2003

	fraud	*terrorist funding*	*drug trafficking*	*internet fraud*	*money laundering*
2002	*160*	*19*	*15*	*9*	
2003	*74*	*20*	*17*	*6*	*15*

Restraint related to SARs
2002: a.o. US$ 1.6 million by United Kingdom injunction. US$ 300,000 was locally restrained civilly.
2003: a.o. US$ 100,000 was locally restrained and US$ 10.2 million restrained by MLAT in two separate matters.

Disclosures from other law enforcement agencies to the FIU:
2002: 5 from Customs Fraud Enforcement Division

Disclosures from FIU to other law enforcement agencies:
2002: 5 to Customs Fraud Enforcement Division
2003: 7 to Customs Fraud Enforcement Division

Spontaneous referrals of information relative to SAR's have been made by the Reporting Authority both locally and overseas (with the Attorney General's consent). No statistics have been kept on the exact figure but the estimate for 2003 is 40.

Statistics are not specifically kept by the FIU for the number of SAR-related prosecutions and convictions. In the last twelve months (six occasions) several matters have been submitted to the Attorney General for consideration of prosecution of persons after the receipt/analysis and investigation of an SAR.

CI doesn't require reporting of large currency transactions. According to the FIU it is unlikely that cash is being imported to Cayman Islands considering the strict control at the borders done by Customs. In case Customs discovers such an import of cash, it will also be reported to the FIU.

Currently, the Attorney General is responsible for the FIU, and its primary functions are:

1. *receiving, analyzing and disseminating disclosures of financial information*
2. *responding to informal and formal requests for assistance in financial crime matters*
3. *investigation of money laundering cases by gathering the evidence for prosecution decision*
4. *investigation in response to mutual assistance requests relating to money laundering*

Amendments to PCCL in October 2003 restructure the framework of this agency by providing it with an articulated statutory basis that introduces a clear separation between receiving SAR's (may concern information about (suspected) proceeds of crime, (suspected) money laundering but also terrorism or the financing of terrorism) from the reporting entities and the investigation of SAR's. The reporting side, to be named the Financial Reporting Authority (FRA), will be in charge of the reports received. The FRA will be the FIU, in charge of receiving, analyzing and disseminating disclosures of financial information and will be comprised of civilians. The Governor can appoint after consultation with the Anti-Money Laundering Steering Group, the persons to fill the vacant positions. A detective inspector will be attached to the FRA and will have access to databases of the Police, Immigration, Customs, Prison and conviction files, in the JIU. After the review by the FRA, SARs will be disclosed to the Financial Crime Unit (FCU) as necessary, and the FCU will undertake all investigations into financial crime, including the investigation of all SARs referred by FRA. Another important change of the legislation is the power given to the FRA to require in writing from any person information (excluding information coming to a professional legal adviser in privileged circumstances) for the purpose of clarifying or amplifying information disclosed to the FRA. Non- compliance with this request is an offence. The FRA will consist of a director, a lawyer, an accountant and such other persons having suitable qualifications and experience to become analysts.

Pursuant to section 23 of the PCCL, the FIU shall not further disclose SAR information to foreign authorities without the consent of the Attorney General. The Attorney General may impose conditions on the further disclosure of SAR information. Presently these conditions are:

a) *the information disclosed can only be used for the specific purpose of assisting in a specific investigation;*
b) *prior approval should be requested before using any material for any other purpose;*
c) *formal request is necessary before using any material as evidence in any proceeding; and*
d) *restrain or confiscation of funds can only be done through the PCCL.*

Feedback from the requesting agency on the process of investigation is also requested. The FIU may disclose information in relation to criminal conduct to any law enforcement agency in CI. The FIU is a member of the Egmont Group since 2001.

Under the new statutory framework, the work of the FRA will be overseen and inspected by the Anti-Money Laundering Steering Group, consisting of the Attorney General (chairman), the Financial Secretary (deputy chairman), the Commissioner of Police, the Collector of Customs, the Managing director of the CIMA and the Solicitor General. The Steering Group is important in determining the general administration of the FRA.

At the moment a small section in the RCIP's annual report reflects the work of the FIU. Pursuant to the

amendment of the PCCL, the FRA is required to collect, compile and annually publish statistical information regarding disclosures.
Analysis of Effectiveness
The CI has a FIU, the FRU, that was admitted to the Egmont Group in 2001. FRU and its successor the FRA receives reports, evaluates and disseminates them. CIMA, as the supervisory authority, has issued guidelines to assist financial institutions in identifying suspicious transactions, and provides regular guidance in the way of GN. Recommended reporting procedures are set forth in the GN. Under the new provisions, the FIU has broad authority to require additional information from any person to supplement an SAR. The FIU has full powers to gather additional documentation, and access to a wide range of public and non-public databases. Administrative sanctions, including ultimately license revocation but not currently including fines, are available for failure to comply with obligations through CIMA. There are direct and affirmative provisions supporting the FIU's authority to disseminate information domestically, and with foreign FIUs and other law enforcement authorities although the provisions should be reviewed as they apply to drug trafficking related matters. However, with respect to dissemination to foreign FIUs, the PCCL requires, in the case of disclosures of SARs themselves, the consent of the Attorney General. Although in current practice onward disclosures occur in a timely manner, the provision as a structural matter poses a potential barrier to quick and effective sharing of information and should be reconsidered. In the recent amendments to the PCCL, the FIU has been granted authority to issue guidance, should it believe it is necessary, regarding the form and manner of reporting, but current arrangements with a recommended form have proven satisfactory to date. CIMA may take administrative actions against entities it regulates for failure to comply with the reporting obligation, including license revocation; but, meaningful administrative fines are not yet available. *The financial industry is regulated by CIMA. This industry is well informed about money laundering and suspicious activity via legislation and GNs e.g., Attorneys-at-law, accountants, and realtors for example are not regulated by CIMA but when they engage in relevant financial business as defined in schedule 2 of the MLR, they are required to fully comply with the law, including identification procedures.* *The FRU has been giving feedback to the reporting entities on a regular basis. The FRA should continue giving the reporting entities feedback on the reports received, putting emphasis on suspicious patterns used for money laundering and terrorist financing, trends and typologies like underground banking. Information should be provided on a large scale.* *Furthermore, on-line access to the company's registry should be re-instated as soon as possible to facilitate the work of the FRA.* *The FRA has the authority to exchange information with an FIU, even without an MOU. However, in some cases an overseas FIU's regulations require an MOU, to enable it to exchange information, and in these circumstances an MOU will be necessary. According to section 21A(2)(e) of the amended PCCL, the director of the FRA needs the consent of the Steering Group before he could sign an MOU with another FIU. In such a case, the Steering Group should, without any delay, expedite its consent, if requested by the director of the FRA, enabling the FRA to enter into such arrangements with foreign FIU's. It might be helpful to prepare in advance standard arrangements and to submit these for approval to the Steering Group at one of its first meetings. This way time dedicated to discussion of each separate MOU will be limited.*

Recommendations and Comments
• Permit the FIU Director to make disclosures of SARs to foreign FIUs without Attorney General consent. • Ensure the PCCL, as amended, permits disclosures to overseas authorities in drug trafficking ML matters. • Take actions necessary to make meaningful administrative fines available for failure to report. • Add information on identifying FT transactions to GN. • Provide guidance to the public that all reports go to the FRA notwithstanding provisions of other laws. • Permit the FIU or CIMA to mandate (rather than suggest) reporting form and methods. • *FRA: continue to provide feedback on a regular bases, based on its own experience with SAR's and latest trend and typologies, to financial and non- financial entities and law enforcement agencies on ML and FT through news media and/ or forums and at seminars on these topics.* • *FRA: create, based on own experience with SAR's information booklets about suspicious patterns used for ML and FT in financial and non-financial entities.* • *Provide to FRA on-line access to the company registry database.* • *FRA: prepare standard arrangements for MOU to submit for approval to the Steering Group at one of its first meeting.* • *Keep statistics of number of prosecutions and convictions by JIU.*
Implications for compliance with FATF Recommendations 14, 28, 32
14: Compliant 28: Compliant 32: Largely compliant (ability to disclose in drug matters; disclosures with AG consent)
IV—Law enforcement and prosecution authorities, powers and duties (compliance with criteria 25-33)
Description
Designated law enforcement authorities, which have the responsibility for ensuring that ML and FT offences are properly investigated, are at present the FRU, in conjunction with the RCIP (in the new structure the Financial Crime Unit). Files are prepared for the Attorney General in respect of prosecutions. *The techniques of controlled delivery and undercover operations are not forbidden in CI and are used routinely, primarily in respect of drug trafficking offences by the Drugs Task Force and by Customs. The "Barbados Plan of Action" is used as the bases for controlled delivery. The Barbados Plan of Action was conceived in 1996 to strengthen drug control in the Caribbean. It is comprised of 87 recommendations, intended to be implemented by all of the nations of the Caribbean. The recommendations focus on anti-drug measures in the area of demand reduction, legislation, money laundering, law enforcement, maritime co-operation and national and regional coordination. The plan was ratified at a later meeting in the Dominican Republic and has been subject of various update meetings by the UNDCP. Controlled deliveries are included but the agreement for such activities are covered by article 11 of the Vienna Convention 1988. Police and Customs have internal guidelines for controlled delivery.* *A drugs task force has been formalized. The DTF comprises 23 officers from the police and customs forces. This force is charged with the investigation of drugs trafficking into the islands.*

The Anti-Money Laundering Steering Group has been formally established in the latest amendments of the PCCL and will be responsible for general oversight of the anti-money laundering policy of the Government and the promotion of effective collaboration between regulators and law enforcement agencies

The current FIU is adequately staffed. In the future the FRA will have some new functions to be filled by a lawyer, accountant and analysts. There are no resource concerns for the FIU; it is equipped with 2 high-speed scanners, some 20 computers, Supertext location and document retrieval software and other analytical programs. Annual budget is C$500,000 excluding salaries (C$500,000).

The DTF has only one vessel to patrol the coasts of the Caymans Islands.

The Attorney General's Chambers has a staff complement of six Crown Counsel (criminal).

According to information provided by the FIU, on several occasions in the last twelve months files have been submitted to the Attorney General for consideration of prosecution of persons after the receipt/analysis and investigation of a SAR, resulting in conviction of the persons involved. Several other investigations are ongoing locally that may result in charges being brought. There are other instances in which persons have been charged overseas as a result of onward disclosure of SAR information. Examples include the ENRON matter in the USA, where information from onward disclosures was used by US authorities to formulate MLAT requests, resulting in the arrest and indictment of persons in the USA. In another matter, onward disclosure uncovered a US$350,000 fraud in the USA and again led to MLAT requests and the persons involved in the fraud being indicted.

Furthermore, the FIU provided the following statistics on investigations in connection with SAR's in 2002 and 2003:

Results of SAR's 2002	***R esults of SAR's 2003*** *(to Sep. 29, 2003)*
273 positive (investigation discovered or instigated)	*123 positive*
127 negative	*63 negative*
34 pending	*41 pending*

CIMA informed that over the past five years, there have been four enforcement actions related to ML/FT offences. Two pertained to licensed banks and two to licensed company managers. In all four cases, CIMA appointed controllers to investigate the affairs of the licensees and report to CIMA. In all four cases, the controllers recommended that the licensees be liquidated, and the licensees are all currently in the process of being wound up or have been dissolved.

The FRU co-operates with local law enforcement agencies. Trends and typologies discovered by the FRU in the SAR's are disseminated to other agencies via the JIU.

Several officers of the FRU and of the RCIP have attended training courses organized by CALP, CFATF and IMF/World Bank. Special training and certification for financial investigators has been provided to an officer of the FRU. Three officers at the FRU are taking courses provided by the International Compliance Association based in the UK. In house training has been provided to RCIP officers and prosecutors in the Legal Department 2000 to 2003. Further training is arranged for October 2003.

The Financial Crime Unit's new investigators will be receiving training during January 12–23, 2004 provided by the CALP. Further training is arranged for the super text computerized exhibit handling system on October 10, 2003 when four officers will be trained to train the rest of the Financial Crime Unit officers. Personal development plans for all officers will be instituted and a full program will take place including in house training and mentoring.

There are no problems encountered by the authorities in achieving successful investigations, prosecutions and convictions, and in freezing, seizing and confiscating the proceeds of crime or property to be used to finance terrorism. The separation of the reporting side from the investigative side of the CI financial intelligence unit, will contribute to the prevention of any problems in achieving successful investigations and prosecutions.

Law enforcement authorities are able to employ investigative techniques including controlled deliveries, undercover operations, and when permitted specifically by the Information, Communications and Telecommunications Act 2002, telephone interception. For controlled deliveries, there is no specific legislation. As in countries with similar legal systems, there is no legal impediment to a controlled delivery as long as the operation does not result in the commission of an offence by a law enforcement officer.

Law enforcement authorities are able to compel production of financial records by applying to the Grand Court for an order to compel any person in possession of material including financial institutions to make relevant materials available for an investigation (Sections 29, PCCL and Section 44, MDL).

Analysis of Effectiveness

Authorities in CI have established clear designations of responsibility for investigations into ML and FT with dedicated offices and personnel.

The new positions at the FRA have to be filled as soon as possible with capable persons to execute the functions of the FRA.

Investigative tools appear available, with full acceptance by the courts of controlled deliveries in appropriate circumstances.

CI law enforcement authorities are able to use provisions for the compulsory production of material and search warrants to compel production of bank records and procure disclosure of information not protected by legal privilege. The production order compels a person, including a corporate person, who is possession of the material to hand it over to the police or to give access to it. If a production order is not complied with, the police may apply for a search order. While the TL provides for account monitoring orders, neither the PCCL nor the MDL provide for such orders for investigations into money laundering and tracing of assets, although consideration is being given to enacting specific provisions for account monitoring and tracing.

Recommendations and Comments

- *Recruitment of additional staff of the FRA as soon as possible.*
- *providing of training to new personnel of the FRA and allocating substantial amount of annual budget to provide on a regular basis information about money laundering and terrorist financing to the financial but also non financial sectors of the economy to raise awareness of the possible misuse by criminals of these sectors.*

Implications for compliance with the FATF Recommendation 37

37: Compliant.

V—International Co-operation (compliance with criteria 34-42)

Description

The CI being an OT of the U.K., it cannot enter into treaty relations on its own. It however has a formal bilateral MLAT with the United States, executed by the C.I., the U.S. and the U.K. This treaty, brought into force by the MLAUSL, has a general application in criminal matters and covers a wide range of assistance, from the taking of testimony, the issue of production orders (including the obtaining of records from financial institutions) to the execution of requests for search and seizure, and immobilizing and forfeiting criminally obtained assets. The treaty applies to any criminal offense punishable by imprisonment of 12 months or more under the laws of both countries, and thus includes ML.

Mutual assistance from CI in general does not require a treaty relationship (MLAT) but is subject to the principle of reciprocity. It follows that assistance can be given to a foreign state if the application relates to conduct that would constitute an offense if it had occurred in the jurisdiction. As there are no income taxes in the jurisdiction, dual criminality is not met for most income tax related matters in the mutual assistance setting. However, with respect to the United States, assistance is available under the MLAT for many tax matters as a list supplements the dual criminality provisions of the treaty.

Several pieces of domestic legislation enable the CI to provide mutual assistance. The MDICL, enacted to implement the requirements of the Vienna Convention, is applicable for drug trafficking offenses including drug money laundering. Assistance available under MDICL to overseas jurisdictions that are parties to the Vienna Convention includes production orders, service of judicial documents in the CI, search and seizure, identification

or tracing of proceeds, taking of evidence or statements, immobilization of assets, and assistance in proceedings relating to forfeiture and restitution. If authorities in CI could carry out the action requested for a similar offense in the CI, and the request establishes reasonable grounds for believing a criminal offense has been committed and the information relates to the offense, and granting mutual assistance is not contrary to CI Law or is likely to prejudice essential interests, then assistance is provided (Section 8 (1) MDICL). Under the Third Schedule of the Misuse of Drugs (Drug Trafficking Offences) (Designated Countries) Order 1991, restraint applications may be made on behalf of designated countries in respect of realizable property believed to be the proceeds of drug offences. CI has acted to designate all countries that are parties to the Vienna Convention. Assistance is available at the investigative stage as long as there is a showing of reasonable grounds to believe a covered (drug trafficking/drug ML) offense has been committed.

For non-drug money laundering matters, domestic provisions include the Evidence (Proceedings in Other Jurisdictions) (Cayman Islands) Order 1978 (EPOJ) which provides that upon receipt of a request from a foreign court or tribunal, the court may, if criminal proceedings have been instituted in that country, order documents to be produced and witnesses to be examined. CI authorities also regularly use Section 3(b)(iii) of the CRPL, pursuant to which in cases where police officers are authorized by the Governor to investigate an offense committed elsewhere that would be an offense if it had been committed in CI there is a lifting of secrecy for such purposes. While compliance with requests made by officers under the CRPL is voluntary, there is the protection of the lifting of secrecy for purposes of the request. Police authorities regularly receive information in this way. With the extension of the provisions of the MDICL to all offenses in post-mission amendments (January 2004),the more comprehensive mutual assistance possible under the MDICL is now available for non-drug trafficking offenses.

For FT, in addition to the domestic provisions above, the TL provides that once the ICSFT is extended to the CI, CI may provide mutual legal assistance to any parties to the ICSFT.

In addition, the PCCL provides for the registration (recognition) and enforcement of external (overseas) confiscation orders and restraint orders in support of such potential confiscations for those countries designated by the Governor. All FATF countries have been designated. Authorities may seek production orders and search and seizure order for any offences to which the act applies including foreign offences. The purpose of such confiscation orders may be the recovery of property obtained as a result of or in connection with any offence to which the law applies or the value of such property as well as depriving the person of a pecuniary advantage. (Section 34 -1(e), PCCL). As the PCCL applies to all offences triable on indictment and such conduct outside the jurisdiction as if it had occurred within the jurisdiction, the CI is able to recognize and enforce foreign ML or FT-related confiscation orders if the underlying offence is indictable in CI. As no specific investigative powers are provided for by the PCCL for the identification, tracing and seizure of criminal proceeds on behalf of another jurisdiction, only general production orders and search warrants can be used to assist foreign jurisdictions in such matters. These powers are primarily designed to help identify and seize evidence and not proceeds. Restraint, receivership and charging orders are available to assist foreign jurisdictions in non-drug related ML matters, as well as order for enforcement of monies due as fines. Enforcement of external confiscation orders requires registration by the Grand Court of the CI.

The Attorney General's Chamber serves as the Central Authority for non-US related overseas mutual assistance requests, and the Chief Justice serves as the Central Authority, acting in administrative capacity for requests under the MLAT with the United States.

Assistance to overseas authorities is provided both for ML offenses only and where a person has committed both a predicate offense and ML.

Law enforcement assistance from CI can be obtained through police to police channels, Interpol and WCCIT (White Collar Crime Investigative Team). As well, the FIU which is a member of the Egmont Group, exchanges information through the U.S. FIU, FINCEN, as permitted by PCCL 23(9).

CI law enforcement authorities, particularly the Drugs Task Force of the RCIP and the Customs Department conduct cooperative investigations with other jurisdictions, and coordinate seizure and forfeiture actions. Controlled deliveries are not prohibited and CI courts regularly weigh evidence emanating from controlled deliveries.

The extradition of persons between the jurisdiction and other countries is controlled by the U.K. Extradition Act and the various treaties and orders made under that Act. The provisions of the Act have been extended to CI by Orders in Council. Under the United States of America (Extradition) Order 1976, extradition procedures are in place between the Cayman Islands and the U.S. where the conduct is punishable by imprisonment of 12 months or more in both requesting and requested countries. In 2002, new extradition arrangements for crimes punishable with imprisonment of a least 12 months entered into force between the U.K., other Commonwealth countries and OTs, including CI, under a U.K. statutory instrument extended to CI. The Extradition (Overseas Territories) Order 2002 provides for extradition between the CI and designated commonwealth countries where the conduct is punishable by imprisonment of 12 months or more in both requesting and requested countries. This order has been extended as well to Hong Kong. As ML is punishable by a minimum term of imprisonment of 2 years in CI, these extradition arrangements apply to ML. Under the European Convention on Extradition Order 1990 as extended to the CI by virtue of the European Convention on Extradition (Dependent Territories) Order 1996, extradition arrangements are in place which allow for extradition between CI and Finland, Hungary, Israel, Liechtenstein, Norway, Poland, and Switzerland for any offence punishable by imprisonment of 12 months or more in both requesting and requested countries. As the FT is an offense in CI, CI is currently able to extradite for FT to the wide range of countries with which it has an extradition relationship based upon dual criminality if those countries also have FT offenses. In addition, should ICSFT is extended to CI, CI will be able to extradite to any country a party to the ICSFT.

CI is able to extradite its own nationals to other states, and does not pose objection to doing so.

According to information provided by the Attorney General's Legal Department, different standards between the requesting country and CI concerning the intentional elements of the offence under CI's legislation don't affect CI's ability to provide mutual legal assistance. If the requesting country has the standard "reasonable grounds to suspect" and meanwhile PCCL's standard is "knows or suspects," CI's standard is wider and "reasonable grounds to suspect" will be covered. Based on article 19 of the MLAT, information regarding tax matters is able to be provided to the USA if the funds were obtained in relation to a predicate offence covered by the MLAT.

Police-Police exchange of information occurs in practice through the JIU. Not only financial or money laundering matters go through the JIU, but also all other kinds of information is given on a daily basis to, among others, FBI, US Customs or the White Collar Crime Team(WCCIT). Exchange of information between CI's FIU–overseas FIU, which is SAR-related information, is possible only with the approval of the Attorney General.

The average processing time to completion for an MLAT request for production of documents by the Attorney General's Chambers is six weeks. The processing time for a request for information by the FIU varies depending on whether the FIU first has to generate the information or not. If the FIU has the information already, the processing time will be no more than two days. If the FIU needs to generate, for instance an SAR, then the processing time would be about two weeks on average. In urgent matters the FIU is able to process requests immediately.

Part 6 of the Terrorism Law 2003 deals with extradition and mutual assistance in criminal matters.
Statistics are kept by CI's authorities. Under the MLAT law there have been 219 requests from the U.S. to the Cayman Islands and twenty requests by Cayman Islands to the USA over the period 1986 to 2003.

The FIU received in 2002, besides requests related to SARs, 60 overseas requests for assistance from 16 different countries, mainly from US, Czech Republic, Brazil, and Austria. The nature of the offences involved was various, but fraud and money laundering were the most frequently involved in the requests received. Two requests involved terrorist financing. Out of the 60 requests, thirty-six were responded to within one week of receipt. All requests were responded to.

In 2003, the FIU received 89 overseas requests for assistance from 25 different countries, mainly from USA, Mexico, Austria, Italy and Canada. The nature of the offences involved was various, but fraud and money laundering were again the most frequently involved in the requests received. Seven requests involved terrorist financing. Out of the 89 requests 65 were responded to within one week of receipt. All requests were responded to. Seven requests have been refused due to a lack of information provided by the requester. One request was refused because the information was previously provided and on one occasion the FIU was unable to generate the information requested. Feedback is received from the requesting agencies by the FIU.

The Attorney General's Chambers in conjunction with the RCIP, FIU and DTF coordinate seizures and forfeiture actions. Requests are received by the Attorney General's Chambers where the Senior Crown Counsel in charge of International Co-operation will coordinate and give effect to the request. If it is a money laundering matter, the FIU will be requested to provide a police officer for assistance. The Attorney General's Chambers will prepare the application to the Court and when the order is received from the Court, it is executed. The framework for asset sharing (there are agreements with the USA and Canada) is utilized.

Extradition arrangements are in place, providing for extradition for offences punishable by imprisonment of 12 months of more. Part 6 of the Terrorism law 2003 deals with extradition and mutual assistance in criminal matters. According to information provided by the Attorney General's Legal Department, Part 7, Section 62–72 of the Immigration Law provides for deportation of a person who has been convicted of an offence which carries a term of more than 6 months imprisonment, or if the person is considered by the Governor as being undesirable. Four crown counsels at the Attorney General's chambers are in charge of requests. For the Portfolio of Legal Affairs C$5.1 million is allocated in the annual budget.

Analysis of Effectiveness

CI has a generally sound framework in place for the provision of mutual assistance through domestic provisions and international treaties and arrangements. However, for non-drug trafficking matters, except for the U.S. where there is an MLAT in place, assistance at the investigatory stage is limited. This concern, which is of particular concern as it relates to FT, has been addressed post-mission through amendments to MDICL (January 2004)

For drug trafficking money laundering, the MDICL provides for a full range of assistance which is available at the investigative stage. For other offenses, while CI is able to, and does, provide a wide range of compulsory assistance including bank records at overseas request, at the time of the mission the assistance is available only if criminal proceedings have been instituted, except in the case of U.S. requests for which a MLAT applies. Authorities have recognized the issue of the limitations of the EJOC and CRPL in the provision of mutual assistance in non-drug matters prior to the filing of criminal charges, as well as the limitations regarding the kinds of assistance that are permitted. Although some forms of assistance are at times available through other channels (for instance through FIU channels if it is a matter as to which a SAR has been filed), these limitations pose barriers to the full and effective provision of international assistance in non-drug matters. Accordingly, authorities have now passed legislation that would have the effect of extending the provisions of MDICL to other offenses, thus making assistance available at the investigatory stage as well as making a wider range of assistance available. Extension of the full range of mutual assistance, as well as assistance at the investigatory stage for all serious crimes on, at a minimum, a dual criminality basis, is important to have a fully effective framework in place. The current limitation in Schedule 1 of the MDICL to Vienna Convention countries appears to have had the effect in some instances of making assistance unavailable through this channel to countries not a party to the Vienna Convention, but to whom the Convention has been extended. This should be addressed in the course of the contemplated current extension of the MDICL to a wider range of offenses.

In the absence of becoming a party to the ICSFT, CI is able to provide mutual assistance (within the constraints noted above) and extradition in FT matters. Extension of the MDICL to serious offenses including the FT crimes was important, so that assistance is available at the investigative stage. While a provision of the TL makes mutual assistance and extradition available to all parties to the ICSFT, this provision will be unavailable until the ICSFT is extended by the U.K. to CI. Depending upon the breadth of the provisions of the extension of the MDICL (with respect to range of countries to which it becomes applicable), the extension of the ICSFT may become very important to CI's ability to provide assistance to some countries.

Exchange of information is being done on all levels. The fact that SAR-related information can only be provided to foreign agencies with prior approval of AG might cause delays.

Recommendations and Comments

- Extend to all serious crimes mutual legal assistance at the investigatory stage and the full range of kinds of assistance (as is set forth in the MDICL). This occurred on a post-mission basis (January 2004).
- Ensure that the ICSFT is extended to the CI within a reasonable time frame.
- In conjunction with the extension of the MDICL to all serious crimes, ensure assistance is available to

the widest range of countries and amend limitations to current list of Vienna Convention countries. • Ensure that tracing and monitoring orders are available in support of foreign requests.
Implications for compliance with FATF Recommendations 3, 32, 33, 34, 37, 38, 40, SR I, SR V
3: Compliant 32:Compliant 33:Compliant 34: Compliant 37: Compliant 38: Largely Compliant (tracing and monitoring orders, specific statistics of SARs used in police and prosecution) investigations) 40: Compliant SR I: Compliant SR V: Largely Compliant (tracing and freeze issues)

Assessing Preventive Measures for Financial Institutions

76. In order to assess compliance with the following criteria assessors must verify that: (a) the legal and institutional framework is in place and (b) there are effective supervisory/regulatory measures in force that ensure that those criteria are being properly and effectively implemented by all financial institutions. Both aspects are of equal importance.

Table 4.2. Detailed Assessment of the Legal and Institutional Framework for Financial Institutions and its Effective Implementation

I—General Framework **(compliance with criteria 43 and 44)**
Description
Legal framework Each of the regulated sectors has its own set of legislation, such as the Banking and Trust Companies Law, Insurance Law, Mutual Funds Law, the Securities Investment Business Law and the Money Services Law. Each one regulates, with some differences among them, the granting and revocation of licenses, supervisory powers, inspection function, licensee reporting requirements, record keeping, disclosure of information, penalties for breach of the law, etc. There are also some laws on general matters that are relevant for the assessment of money laundering preventive measures in the financial sector. These are, mainly: a) The MAL that defines CIMA as the regulatory and supervisory body for all financial institutions. b) The MLR that establish the preventive measures that all "relevant financial businesses" must have in place to avoid being used for laundering the proceeds of crimes. These measures include setting up and maintaining procedures about identification, record-keeping, internal reporting procedures as well as training of employees. The obligations are underpinned by an offence to failing to have the procedures and training set up and maintained. c) CRPL that establishes the duty of nondivulgence of information concerning any property which the recipient thereof is not authorized by the principal to divulge, and criminalizes the breach of confidentiality. As an interpretative guide, GN have been issued jointly by CIMA and various industry associations about anti-money laundering obligations of the financial services industry. As the document sets forth, the notes contain general guidance. The courts will take them into consideration in determining whether there is compliance with the MLR, but they are not mandatory.

Scope of the AML regulations

The MLR establish the preventive measures relevant financial businesses must have in place. These regulations apply to a person carrying on "relevant financial business," which are licensed banking, insurance (not including property and casualty) and trustee services, mutual fund administration, mutual funds, company management business, business carried on by a cooperative society and acceptance of deposits by a building society as well as a list of other financial activities specified in Schedule 2 of MLR that cover businesses carrying on financial activities both with and without a license. Among them are money transmission services, financial leasing, portfolio management or advice, securities investment business, money broking, services including financial and legal services provided in the course of a business for the sale, purchase or mortgage of land, trading (in money market instruments, foreign exchange, derivatives), issuing and administering means of payment including credit cards, traveller's checks and banker drafts, etc.

Money transmission and currency exchange providers must be licensed in the CI under the Money Services Law. Attorneys and accountants are subject to the MLR to the extent they are engaged in relevant financial businesses. CIMA has sought ways to monitor compliance. For attorneys and accountants, consideration is being given to legislation that would require an annual certificate of compliance with the MLR, with false statements constituting an offence. Upon enactment of the draft accountants law, licensed accountants will be required to file a statement of compliance. The GN provides sector specific guidance for the real estate industry such as information on when identity must be verified, the documentary evidence of source of funds and other matters.

Regulator/supervisor

CIMA, established under MAL, is the regulatory authority for the financial sector in the CI. It has responsibility for the regulation and supervision of "financial services business," that is, any business regulated under any regulatory law (Section 6(1)(b) and 2, MAL). This includes the businesses of banking, insurance, mutual funds and mutual fund administration; company management and trustee or fiduciary services, and money transmission and currency exchange services among others. The SIBL, which came into effect in July 2003 requires licensing of those persons dealing in or managing securities, arranging deals in securities, and advising on securities as of January 2004. CIMA has the authority to regulate and supervise FSPs, and specifically to monitor their compliance with money laundering regulations (Section 6(1)(b), MAL).

A duty is imposed on CIMA and its employees and agents to report suspicions of ML to the FIU (Sections 15–16 MLR).

Confidentiality

Under CRPL, it is a criminal offence to divulge confidential information with respect to business of a professional nature however obtained unless it is divulged pursuant to the directions of the Grand Court, or divulging the information is permitted under the exceptions set forth in the law. Section 5, CRPL. Confidential information includes information concerning any property which the recipient is not, otherwise than in the normal course of business, authorized by the principal to disclose (Section 2, CRPL).

In addition to disclosures under the authority of the court, information may be disclosed and the law has no application to divulging information to a constable of a rank of Inspector or above investigating an offence committed within the jurisdiction, or if authorized by the Governor investigating an offence committed elsewhere assuming dual criminality, or if disclosure is in accordance with any other law. Furthermore, Section 3 of CRPL sets forth circumstances where confidentiality is inapplicable and Section 4 provides directions regarding the provision of confidential information as evidence.

Disclosure of information to authorities

Under Section 27(4) of the PCCL, where a person discloses to the Reporting Authority his suspicion or belief that another person is engaged in money laundering or any information or other matter upon which that suspicion or belief is based, the disclosure shall not be treated as a breach of any restriction imposed by statute or otherwise.

Under Section 43(3) of the MDL, where a person discloses to the authorities a suspicion or belief or any matter upon which that suspicion or belief is based, the disclosure shall not be treated as a breach of any restriction upon

disclosure imposed by contract or by any law.

Under Section 15(1) of the MDICL, where a person divulges confidential information or gives any testimony in conformity with a request, that person shall not be considered to have committed an offence under the CRPL by reason only of such disclosure or the giving of such testimony.

Likewise, there is protection against civil and criminal proceedings for those making disclosures regarding FT or terrorist property to the authorities. Under Section 17(3) of the TL, no civil or criminal proceedings shall lie against any person for disclosing any information in good faith that may be of assistance in preventing the commission of an act of terrorism or securing the arrest or prosecution of a person for an offence under the law, including money laundering and terrorist financing provisions. Under Section 8(2) of TUNMOTO, disclosures shall not be treated as a breach of any restriction imposed by statute or otherwise.

Thus, although all persons including institutions have a general duty not to provide confidential information, there is an exception under the CRPL if pursuant to another law information is provided to the police or a public officer authorized to obtain the information (for instance the FIU) or to a court in an investigation or prosecution.

Confidentiality provisions do not limit CIMA's access to records held by FSPs, as CIMA may at all reasonable times, by notice in writing to a regulated person, a connected person, or a person reasonably believed to have information, require the provision of information and the production of specified documents or documents of a specified description. Section 38(8), MAL.

Disclosure of information by authorities and others

Under Section 49 of MAL, confidentiality is lifted for purposes of CIMA making disclosures for purposes of domestic law enforcement requests. Section 49(2) provides an exception to the general confidentiality responsibilities of CIMA in the case where a disclosure is lawfully required or permitted by a CI court of competent jurisdiction, or for the purpose of assisting CIMA to exercise functions conferred by MAL, any other law or regulations issued hereunder. In addition, CIMA is required to file SARs and in this way discloses information to the FIU.

Under Section 22 of PCCL, the FIU may make disclosure to any domestic law enforcement agency if there is prima facie evidence of criminal conduct or if there is cause to suspect criminal conduct, and also may disclose to CIMA. For overseas disclosures as it relates to the disclosures of SARs, there must be Attorney General consent.

Under Section 10 of the MLAUSL, a person who divulges confidential information or gives any testimony in conformity with a request shall not be deemed to have committed an offence under the CRPL.

In addition, under Section 29(8)(b) of the PCCL, an order to make material available directed to a person, including a financial institution, has effect notwithstanding any obligation as to confidentiality or other restrictions on disclosure whether imposed by the CRPL or any other law or common law.

Designated competent authorities

CIMA serves as the competent authority with primary responsibility for ensuring effective implementation of FATF 40 with respect to preventative measures (Section 6, MAL). The Attorney General serves as the competent authority for prosecutions under the ML and FT laws and for mutual legal assistance. The FIU serves as the competent authority for making and receiving SARs, for both ML and FT. An AML Steering Committee consisting of the Attorney General, the Financial Secretary, the Commissioner of Police, the Collector of Customs, the Managing Director of CIMA and the Solicitor General serves as the central coordinating body for AML, and as a practical matter for FT as well. The Steering Committee is responsible for oversight of CI's AML policy, and under PCCL Amendments 2003 (received assent December 2003) for policy and general administrative oversight of the newly structured FIU (Section 21B, PCCL Amendments 2003). The Guidance Notes Committee, chaired by CIMA's MD includes representatives from private sectors and is charged with developing AML guidance for the financial industry and meets at least quarterly.

As the single regulatory authority for banks, insurance companies, trust companies, company management, and securities firms and money exchange and remittance firms, CIMA seeks to ensure compliance of the regulated

financial institutions with AML/CFT requirements in the course of carrying out its supervisory responsibilities. At the supervisory level, CIMA conducts on-site inspections of financial institutions to verify compliance with various legal requirements, including measures against ML. It reviews financial institutions' compliance with the requirements of the MLR through on-site inspections and internal and external audit reports. If non-compliance is observed, financial institutions are required to take remedial measures. GN address some matters relevant to FT as well, including charities and non-profits, wire transfers, and in the course of on-site inspections, it reviews policies with respect to such matters as whether banks and other financial institutions have given attention to UN and other lists. As the regulator for both banks and money services businesses, it has a reporting role with respect to CFT.

Money Services:

Those involved in the money services business are regulated by CIMA pursuant to the Money Services Law. It is an offence to carry on money services business without a licence (Section 4 of the Law). Pursuant to section 18(2) CIMA is required to take all necessary action to ensure the proper and just implementation of this law. Information provided by CIMA shows that whenever CIMA has information that the Law is being violated, CIMA would either make a SAR where ML/FT is suspected and/or report it to the RCIP,, if it is doing business without a licence. RCIP will investigate the situation and lay charges where appropriate. When the Law was enacted in 2000, CIMA wrote to all the known money transmitters and advertised in the newspaper and advised those in the money services business that they need to get licensed. As far as CIMA is aware, all remitters are licensed.

Analysis of Effectiveness

Legal and Institutional

Statutory provision has been made for the lifting of confidentiality requirements for AML/CFT purposes.

There is a clear designation of authority for monitoring of preventative measures for AML compliance, but the designation is not explicit for CFT.

Implementation

In April 2001, CIMA issued a complete set of "Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands" to FSPs in accordance with the Money Laundering Regulations, 2000. These notes replaced the Code of Practice, previously issued under the Proceeds of Criminal Conduct Law 2000 and a revised version was issued in September 2003. In this respect, sections have been added to address real estate, high-risk countries, wire transfers, and non-profit associations. The GN apply to all relevant FSPs and provide a thorough framework for FSPs to establish their own internal AML/CFT policies and procedures in all sectors. While the GN contains sector specific guidance, they do not contain specific guidance for certain businesses in the securities industry such as market intermediaries. In practice, however, many securities brokers and managers appear to have implemented their own KYC and related policies. The GN do not cover FT.

In accordance with Section 6 (1)(b) of the MAL, CIMA is responsible for monitoring compliance with the money laundering regulations. This duty is carried out in each of CIMA's supervisory departments for the most part as part of the off-site and on-site planning and inspection processes. Inspection manuals for each relevant business sector (i.e., banks and trust, insurance, mutual fund administration, and company management) include a specific program for AML compliance which incorporate the principles and procedures contained in the GN and these appear adequate. Specifically, CIMA reviews the policies and procedures in place, reviews internal and external auditors' reports, reviews the Board of Directors minutes, assesses compliance with internal and regulatory policies and performs a KYC due diligence review by sampling a number of client files. CIMA also verifies that proper logs of suspicious activity reports are maintained. Findings and recommendations are included in the inspection report and are closely monitored.

The regulation exempts property and casualty insurance providers from the definition of "relevant financial business" and, therefore, these entities are excluded from the AML requirements. CIMA, however, supervises these entities and given the low AML risk related to these activities in this jurisdiction this exemption appears reasonable.

Recommendations and Comments

- Amend the MAL and/or other appropriate laws to designate responsibility for CFT.
- Consider incorporating guidance regarding the activities of securities brokers, advisors, and managers into the GN.

Implications for compliance with FATF Recommendation 2
2: Compliant
II—Customer identification **(compliance with criteria 45-48 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 68-83 for the banking sector, criteria 101-104 for the insurance sector and criterion 111 for the securities sector)**
Description
The MLR prohibits the forming of business relationships or the carrying out of one-off transactions unless a person in the course of relevant financial business (including mutual funds) maintains identification procedures that meet specified requirements. Section 5 (1). Persons obliged to identify their customers are those carrying on relevant financial business, which covers licensed banking and trust business, insurance business, mutual fund administration, company management and cooperative society businesses, acceptance of building society deposits as well as other financial activities specified in the Second Schedule. (See details of regulated institutions in section 1 of this Table—General Framework). **When is identification required?** • The MLR requires that relevant financial business have customer identification procedures in place that require as soon as is reasonably practicable after contact is first made either the production of satisfactory evidence of identity by the applicant, or measures set forth in the procedures that will produce satisfactory evidence of identity. • Occasional transactions are referred to in the regulations as "one-off" transactions. In this case, identification is required of the financial institution if: it knows or suspects that the applicant for business is engaged in money laundering or is carried out on behalf of another person engaged in money laundering (Section 7(3)), or the amount is $15,000 or greater in a single transaction (Section 7(4)), or there are several linked transactions payable by or to the applicant, with the amount $15,000 or greater (Section 7(5)) **Consequences of lack of identification** • MLR clearly state that "where that evidence is not obtained the business relationship or one-off transaction in question shall not proceed any further." (Section 7(1)). **Evidence of identification** • Regulated institutions must obtain satisfactory evidence of a client's identity. (Section 7(1)(a)). • The evidence of identity is considered satisfactory if (Section 11(1)): a) it is reasonably capable of establishing that an applicant is the person he claims to be; and b) the person who obtains the evidence is satisfied, in accordance with the procedures maintained under the regulations that the evidence does establish the applicant is the person he claims to be. • Payments debited from a bank account at a bank licensed in CI or regulated in a county with equivalent legislation (all FATF countries and some others as set forth in the Third Schedule) may be acceptable evidence of a person's identity where it is reasonable for the payment to be made by post or electronic means, and it is reasonable for the details of the payment to be sent by telephone or electronic means. (Section 8) • The GN provide that identification documents should be either original or certified copies, presigned and with a photograph, as a current valid passport, driver's license, employer or armed forces card, and that there should be verification of name and address by one of several methods. (GN, Sections 3.14, 3.15, and 3.17). • If the applicant for business is or appears to be acting otherwise than as a principal, there must be reasonable measures taken to establish the identity of any person on whose behalf the applicant for business is acting with reasonable measures determined by all the circumstances and best practice being followed in the

relevant field of business. (Section 9).

Timely identification

- Identification is required as soon as is reasonably practicable after contact is first made between the relevant financial business and the applicant for business. Account shall be taken of the nature of the business relationship, geographical location, whether is practical to obtain evidence before money passes and the amount of the transaction (Section 11(2)).

Business Relationships formed prior to September 1, 2000

Identification requirements have been made applicable to business relationships formed prior to September 1, 2000 through transitional provisions. Section 17 of the amended 2001 money laundering regulation required subjected financial service providers to conduct retrospective due diligence on all relationships established prior to September 1, 2000. The CI was only one of two financial jurisdictions required to undergo such an exercise by the international standard setting community and the deadline for completion was September 30, 2003. FSPs were given two years to comply with this requirement and the industry has been firmly committed to completing this burdensome, but worthwhile, exercise. Some relationships have been rightly terminated and for those accounts for which identification have yet to be confirmed, CIMA is intending to adopt an risk-based approach in dealing with those institutions who were unable to obtain satisfactory customer identification. FSPs are required to report the total number and value of all accounts for which proper identification was not obtained.

However, in order to reduce regulatory burden, CIMA implemented a flexible system with respect to introduced businesses whereby FSPs could obtain from the introducer assurance that the existing relationship was bona fide and the existing client is not suspected of any money laundering activities.

Exemptions for other financial business

- It is not required that evidence of a person's identity be obtained where there are reasonable grounds for believing that the applicant for business is a person who is carrying on relevant financial business.(Section 10(a)).

Identification procedures for transactions on behalf of another

- Under Section 9(4) of the MLR, if an applicant for business is overseen by a Schedule 3 (generally FATF) country overseas regulator (that is, it is a business over which a overseas regulatory authority exercises a regulatory function), the institution regulated in CI may accept a written assurance from the applicant for business that the customer due diligence on the principal has been obtained and recorded by the applicant for business.

Wire Transfers

- As yet, there is no legally binding requirement in CI law that requires regulated institutions to include detailed originator and beneficiary information on funds transfers and related messages, although the GN encourage FSPs to ensure that details of senders and beneficiaries are incorporated in all payment and message systems such as SWIFT (GN 4.10), and this appear to be a common banking practice. CI recognizes the period for adoption should be no longer than two years after adoption of the interpretative note.

Anonymous Accounts

- CIMA prohibits FSPs from maintaining anonymous accounts or accounts in fictitious names through the requirement in the regulations that FSPs undertake proper identification, and maintain records of identification. Under the MLR, financial institutions must obtain satisfactory evidence of the customer's identity, and have effective procedures for verifying the bona fides of a new customer**,** and must maintain records of such identification.

Renewal of Identity if doubts appear

- There are no specific requirements regarding renewal of identity if doubts appear.

Industry Practice:

The majority of the client base of the financial industry in Cayman is institutional; however, important business is also derived from private clients. The banking sector follows a universal banking structure where the "one- stop shopping" concept dominates. Services provided by some FSPs include banking, insurance, mutual fund administration, and corporate and trust services.

In general: Based upon the FSPs visited, it appears FSPs have developed graduated customer acceptance policies based on their own client base and have identified specific categories of high-risk customers and businesses. In dealing with these higher risk clients, enhanced due diligence is applied and approval from senior management is required. For FSPs headquartered abroad, approval to establish certain client relationships is required from various head offices. In some cases, banks have adopted a "no tolerance" policy and disallow certain client relationships to exist at all (e.g., PEPs, "hold mail" accounts, casinos, operators of pornography business). FSPs conduct considerable due diligence on intermediaries to ensure that the intermediary is applying satisfactory procedures to obtain client identification. If satisfaction is not obtained, the FSP will conduct its own due diligence on the prospective client.

Many FSPs utilize commercial software programs to aid in conducting their customer due diligence.

The GN recommend FSPs to obtain more than one source document to confirm identity and encourage the use of public sources to aid in determining the identity of its prospective clients and obtaining additional information regarding the client's business. World-Check database, the internet, and other public databases are utilized.

Anonymous and numbered accounts are not addressed specifically by the regulation or the GN; however, the effect of the law and regulation require identification. Discussions with several bankers indicated that internal policies prohibit either type of account to be established.

FSPs have been filing suspicious activity reports for prospective clients who have been refused services at their own institutions, and in practice, this information circulates throughout the community quite rapidly to alert other FSPs of a possible risky situation. While a tipping off offence does not exist, the practice could appear to constitute a tipping off.

With respect to trusts and private banking, the GN address the KYC requirements in an appropriate manner while also addressing the legitimate concerns regarding the possible abuse of these services by money launderers and urge FSPs to be particularly vigilant in this area. FSPs are required to give enhanced scrutiny to clients from high risk countries, total changes of beneficiaries, unexplained requests for anonymity or confidentiality, beneficiaries with no apparent connection to the settler, the source of assets intended to settle the trust, objectives of the settler in creating the trust, and any unexplained urgency in establishing a trust before adequate due diligence can be conducted.

Cayman's law allows the issuance of bearer shares; however, since April 2002 they have been immobilized by requiring a recognized custodian or a custodian authorized by CIMA to physically hold the instruments to the order of the beneficial owner. CIMA indicated that most bearer shares are debt instruments issued in the European market and since the deadline for immobilization, the demand has decreased significantly.

In general, Cayman banks do not provide correspondent banking services abroad and for those foreign banking institutions wishing to provide correspondent banking services to Cayman institutions, Cayman banks indicated that these institutions have visited and conducted due diligence on their operations. There appears to be good working relationships between various jurisdictions.

Introduced Business: The GN allow for FSPs to accept introductions from three sources: (1) intragroup (i.e., parent company, branch, subsidiary) introductions if the KYC standards of the introducer are equivalent to Cayman and are being strictly followed; (2) entities or persons covered by the Cayman regulations, financial institutions in countries with equivalent legislation; and (3) professional intermediaries in countries with equivalent legislation (i.e.,

"Schedule 3 country"), if the intermediary has provided written assurance attesting that evidence of the identity of the person/entity being introduced has been obtained and copies of this evidence will be provided upon request. In addition, senior management must approve the written assurance.

Countries deemed to have equivalent legislation are contained in Schedule 3 of the MLR. CIMA considers various factors in determining the countries recommended for inclusion. The main criteria in determining which countries are to be included are whether a country or territory has equivalency in its legislation and evidence that there is an effective anti-money laundering regime. In determining equivalency and effectiveness, factors considered include effective and comprehensive suspicious transaction reporting system, financial intelligence unit or equivalent, financial regulatory system, and international cooperation as well as membership in international/regional anti-money laundering bodies or associations and a favourable assessment by an international or regional standard setter or other international body.

In practice, discussions with FSPs indicated that most conduct their own KYC due diligence and little reliance is placed on introducers or intermediaries. Intragroup introductions, while allowed, are not always used and FSPs apply their own KYC due diligence. In cases where intermediaries are used, thorough due diligence is conducted on the intermediary and, if necessary, on the client. In addition, discussions with the private sector indicated that most of the company service provider clients are institutional so the risk may be lower.

Analysis of Effectiveness

Legal and Institutional

Anonymous accounts

While there is not a specific prohibition to maintain anonymous accounts or accounts in fictitious names, both supervisors and the regulated institutions regard anonymous accounts as forbidden based on general identification obligations. Also, the banks indicated they have never had such accounts in the past.

Wire Transfers

Current provisions regarding wire identification appear as guidance. Bankers met during the assessment indicated that, as part of their internal policies, they include detailed information in all wire transfers (for beneficiary and originator).

Third Party Due Diligence

Regulated institutions are allowed to rely heavily on third-party due diligence procedures, both locally and from other jurisdictions. Money launderers could abuse the broad exemption for identification evidence granted to operations between two "relevant financial businesses." The exemption provision has the practical effect of exempting all accounts and transactions made, directly or on behalf of a client, with: insurers; corporate or trust service providers; mutual fund administrators; investment dealers, traders, securities brokers, mutual funds, and portfolio managers; money remitters, and all other businesses listed in Schedule 2 and in section 4 of the MLR, licensed either in CI or in a foreign jurisdiction.

- While there are valid reasons for exempting from an enhanced due diligence any transaction between two banks licensed in CI it may not always be reasonable to exempt any transaction between any "relevant financial businesses," at home or abroad given the broad definition of this term.

In practice, banks do not seem to make use of the exemption. They tend to require proof of identification from all their customers, even when introduced by other banks. It is not clear with other providers the extent to which this is the case.

Implementation

An underlying objective of the principles supporting the GN is for FSPs to gain a full understanding of the business relationship and the nature of the business the customer or ultimate client expects to undertake and to be aware of specific categories of high-risk customers and high-risk businesses which may be vulnerable to money laundering schemes. The GN adequately discuss the principles and procedures to be applied by FSPs in ensuring that sufficient information is obtained on the prospective client's business and identification.

For those prospective clients whose identity cannot be obtained, the regulation states "the business relationship or one-off transaction in question shall not proceed any further."

Wire Transfers: The GN have recently been revised to encourage FSPs to obtain originator information on wire transfers. Discussions with several bankers indicated that their institutions have implemented various policies regarding wire transfers including prohibiting the acceptance of wire transfers without originator information. In most cases, banks do not provide wire transfer services for non-customers (e.g., tourists). Requiring this information to be obtained would strengthen the guidance in this area and comport with international standards. However, the international standard provides for a two-year adoption period to allow financial services providers to adapt to systems.

Securities: Mutual fund administrators, which are supervised by CIMA, are required to apply KYC procedures to the prospective investors and discussions with industry representatives indicated the identity of the ultimate client or beneficial owner is being obtained. Market intermediaries, such as brokers, advisors, and managers, while not yet licensed by CIMA, are in practice, implementing their own internal AML/CFT program; however, oversight in this area has been conducted by Cayman Islands Stock Exchange and not all such entities are members of the exchange. The licensing process for persons currently involved in the securities investment business has a deadline of January 2004. Persons commencing securities investment business since July 29, 2003, are required to apply for a new license. CIMA expects approximately 25 to apply for a license. CIMA intends to conduct on-site inspections on licensees using a risk-based approach (i.e., non-members of the Exchange or non-bank affiliates—approximately 8 to 10). Since the non-members were subject to MLR, it seems prudent for CIMA to include an AML inspection during these inspections.

Insurance: The GN provide details regarding the types of applicants for business and the necessary procedures to follow for obtaining identification and the necessary information to be obtained and maintained; however, the notes could be enhanced to make clear that identification needs to be verified if claims, commissions, and other monies are to be paid to persons other than the policyholder.

Trust and Company Service Providers: The GN provide a separate section on company managers and require company managers to conduct due diligence on the introducers or intermediaries to ensure their eligibility and ensure that written assurance is obtained regarding beneficial ownership and access to documents.

Introduced Business

While it appears that many FSPs may not be relying on eligible introducers to perform KYC due diligence, the GN support such practices. Indeed, while it may be appropriate to accept introduced business in many situations, the GN cast a wide net by allowing intermediaries from a Schedule 3 country to introduce business to Cayman FSPs even though Schedule 3 eligibility includes consideration of reports received from international/regional associations. Granted, the FSP's senior management must assess the eligibility of the introducer and give his approval and the eligible introducer must attest that they have obtained satisfactory evidence of customer identification. However, the standard used to determine satisfactory evidence regarding customer identification is that which is required in the Schedule 3 country, which may not be of the same degree as in Cayman. FSPs are ultimately responsible for obtaining proper identification of its ultimate client and ensuring that proper customer due diligence has been conducted by a regulated entity and since FSPs are allowed to rely on introducers, FSPs should establish adequate mechanisms for ensuring that the intermediary has engaged in a sound due diligence process. To this end, consideration should be given to enhancing the current mechanism. In this respect, to provide the FSP with additional assurance, the eligible introducer form could be made clearer regarding the disclosure of beneficial owners, shareholders, or controllers so that independent contact with the ultimate customer by the FSP may occur, if necessary. In addition, introducers could attest that proper CDD has occurred and the FSP has ready access to the customer information.

Recommendations and Comments

- Consider enhancing the GN with respect to customer identification contained in the insurance sector section if claims, commissions and other monies are paid to persons other than policyholders.

- Consider revising the eligible introducer's form to require disclosure of controller, beneficial ownership, and to require the introducer to attest to performing proper customer due diligence and that information will

be made available upon request without delay. • Consider appropriate limitations on the exemption in the MLR from identification requirements applicable to transactions made by, or through other financial businesses, to, for instance, low risk transactions and incorporate into the exemption provision in the MLR that a FSP is ultimately responsible for ensuring adequate due diligence procedures and satisfactory documentary evidence from the introducer. • Consider conducting, an AML review of prospective licensees deemed to be "high risk" during the licensing process for securities brokers, advisors, and managers. • Make it mandatory for all relevant financial businesses to verify the identity of their customers, rather than to "maintain procedures to identify." • Address in a more specific manner the need for renewal of identity if doubts appear (FATF 10/Criterion 46). • Within the two-year period referred to by FATF, amend relevant laws to require that accurate and meaningful originator information (name, address and account number) on funds transfers and ensure it remains with the transfer throughout the payment chain. • As a supplement to the adoption of a mandatory requirement regarding wire transfers, tighten the GN regarding originator information on all wire transfers.
Implications for compliance with FATF Recommendations 10, 11, SR VII
10: Largely compliant (only required to maintain procedures to identify; need to address more specifically renewals of identity in cases of doubt; broad exemption to CDD requirements and introduced business regime with exemption provision having the practical effect of exempting all accounts and transactions made although it may not always be reasonable to exempt any transaction between any "relevant financial businesses") 11: Compliant SRVII: Not yet compliant (awaiting implementation period)
III—Ongoing monitoring of accounts and transactions **(compliance with Criteria 49-51 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 84-87 for the banking sector, and criterion 104 for the insurance sector)**
Description
FSPs must maintain procedures for the filing of SARs and there are duties to disclose enforced by criminal sanctions where there is knowledge or suspicion that another person is engaged in ML or FT. GN at 4.1–4.5 provides for ongoing monitoring but the GN do not appear to address maintenance of findings in writing and provision for keeing such findings available for competent authorities. The GN do suggest that an MLRO would be "well advised" to record reasons for a decision not to report a suspicion reported to him/her. GN at 5.24. There is also a general legal requirement is set forth in Section 5(1)(iv) of the MLR, and consists of a requirement that FSPs maintain procedures of internal control as may be appropriate for the purposes of forestalling and preventing money laundering. Most banks have systems in place to monitor significant transactions. There is guidance that FSPs should exercise additional caution and conduct enhanced due diligence on individuals and entities based in high risk countries (GN 3.47-3.49). GN provide useful examples of suspicious transactions (Appendix K) and suggest FSPs monitor the conduct of a relationship/account to ensure it is consistent with the nature of the business stated when the account was opened and have systems and controls in place for significant changes or inconsistencies in the pattern of transactions. GN 4.1, 4.2. Section 8 of the GN pertaining to the Trusts sector (paragraphs 6 and 7) discusses the possible abuse of trusts by money launderers and describes circumstances that should prompt increased vigilance on behalf of financial services providers. Areas that should be of concern include links with high risk countries, total changes of beneficiaries, unexplained requests for anonymity, beneficiaries with no apparent connection to the settler and unexplained urgency.

Incoming Wire Transfers. Currently, CI has no specific requirement, only guidance, for enhanced scrutiny of wire transfers lacking complete originator information. The GN indicate that information accompanying wire transfers should ideally identify the originator, and FSPs should ideally have effective procedures in place to identify transfers lacking complete information. GN, Section 4.11. FSPs are encouraged to ensure adherence to international practice with the recognition that FSPs are reliant upon transmitting institutions and it will usually be overly burdensome for FSPs to conduct verification on all incomplete wire transfers. Section 4.12, GN. Lack of originator information may be considered as a factor in determining whether a transaction is suspicious. Section 4.13, GN.

Implementation

FSP's have adopted appropriate risk-based approaches to monitor their clients' activities, which are in line with their customer acceptance policies. The GN contain descriptions of different types of suspicious activities for each sector and address various high-risk categories of services/clients (e.g., PEPs, High-risk countries, charities and non-profit associations, trusts, structured finance companies, bearer shares, certain insurance transactions, and shell corporations). The industry appears conscious of the risks associated with certain types of high-risk financial services and clients conducting business in their jurisdiction and appear to be vigilant in monitoring the activities and are filing suspicious activity reports when warranted. In 2002, the FIU received 443 SARs from FSPs and professionals (including attorneys, accountants, and realtors) and so far in 2003, the FIU has received 227 SARs.

Analysis of Effectiveness

Legal and Institutional

There should be clear direction to FSPs that they maintain complete files, available for later review, on all transactions brought to the attention of the relevant officer, including those not reported to the FIU and on complex or unusual transactions with no visible purpose that have been reviewed

With respect to incoming wire transfers, there is as yet no requirement in place only guidance that suggests what "ideally" FSPs should do. Recognizing that there is a two-year phase in for the FATF requirement, all efforts should be made to comply as soon as possible. Measures in place rather than encouraging institutions to comply with SR VII as quickly as possible, note that verification of incomplete wire transfers may be "overly burdensome."

Implementation

CIMA reviews suspicious activity registers to ensure compliance with the policies and procedures; however, the Authority does not review the actual reports. As a cross-check, it might be useful for CIMA to randomly cross-check the register with the actual reports to ensure reports reflect the institution's policies.

Computerized programs are utilized to monitor activities and CIMA posts a lists of suspected individuals for financing of terrorism obtained from various sources on its websites.

Insurance: The GN contain limited sector specific guidance in this area; however, the insurance managers appear to monitor their client's activities closely and are aware of the potential ML schemes. Books and records of captives are maintained on-site and transactions are reviewed closely. In some cases, however, company service providers may act as third party administrators and handle payments of claims after a thorough approval process has taken place. All captives are required to have audited financial statements which are submitted to CIMA. CIMA maintains a watch list which contains a list of entities and individuals which require monitoring for supervisory purposes and also included in this system are procedures that allow CIMA to identify entities and individuals previously charged with ML offences. In addition, in accordance with the Insurance Law, insurance providers are required to report to CIMA changes in beneficial ownership, business plans, and dividend payments.

Recommendations and Comments

- Make certain there is clear direction to FSPs to maintain files on all transactions brought to the attention of relevant officers and on other transactions that have been examined as complex or unusual with no visible purpose.

- Impose an obligation on FSPs, consistent with SR VII and at least within the two-year phase in period, to give enhanced scrutiny to wire transfers that do not contain complete originator information and provide guidance that encourages compliance on an immediate basis.

- Consider enhancing GN to encourage insurance providers to be particularly vigilant to the particular risks in the industry or other particular types of suspicious transactions such as the use of single premium unit-linked policies, unusual early redemption of an insurance policy; payment of claims or high commission to an unusual intermediary. Stressing the importance of solid internal controls within insurance entities may also be useful since weak internal controls for general operating purposes will probably result in ineffective internal controls for AML/CFT.

Implications for compliance with FATF Recommendations 14, 21, 28, SR VII

14: Largely compliant (lack of clear direction regarding maintaining files on all transactions brought to attention of relevant officers and other transactions examined and reviewed under ongoing monitoring policies.)
21: Compliant
28: Compliant
SRVII: Not yet compliant (awaiting implementation period)

IV—Record keeping

(compliance with Criteria 52-54 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 88 for the banking sector, criteria 106 and 107 for the insurance sector, and criterion 112 for the securities sector)

Description

- Under sections 5 and 12 and of the MLR, persons who carry on a relevant financial business are required to maintain record-keeping procedures when they engage in a business relationship or carry out a one-off transaction. These procedures must require the keeping of records for not less than five years commencing on the date on which the business relationship or one-off transaction was completed.

- The MLR requirement is for procedures to be in place rather than that records be maintained.

- The record-keeping period of 5 years begins <u>from the date of termination of the relationship</u> with a customer (MLR, Sec.7 (2)).

- Under Section 12 MLR, record keeping procedure are in accordance with the MLR if they cover the following:

  (i) where evidence of a person's identity is obtained to establish a business relationship or as a basis for a one-off transaction, a record indicating the nature of the evidence and either a) comprises a copy of the evidence; b) provides information as would enable a copy of the evidence to be obtained; or c) provides sufficient information to enable the details of the person's identity as contained in the evidence to be re-obtained, and

  (ii) a record that contains details relating to all transactions carried out by the person in the course of the relevant financial business.

  (iii) where the person carrying on relevant financial business believes that the applicant for business has become insolvent and takes any action to recover all or part of any debt due and payable to him, a record of the actions taken to recover such debts for not less than five years commencing on the date on which the first action was taken.

- The GN in addition to summarizing the law, note the kinds of records that will generally comprise records relating to transactions. (Section 7.4, GN.) The GN also provide that if a FSP has delegated any record keeping functions to a person or institution in a Schedule 3 (generally FATF) jurisdiction, it must be satisfied that they will be maintained in accordance with the regulation and available to CIMA, the FIU and law enforcement upon request. Where group records are stored centrally off island, FSPs should ensure the records can be retrieved promptly upon request.

- The MLR and GN are silent with respect to supplementary account information.

A failure by a relevant financial business to maintain record keeping procedures is punishable as an offense under Section 5 (2) of the MLR.

In practice, the record keeping requirements together with various access provisions for law enforcement authorities ensure that both customer and transaction records are available to domestic authorities for AML/CFT investigations and prosecutions.

Implementation

The GN address the MLR requirement that FSPs to maintain adequate customer identification and relevant transaction files for five years. Although this requirement may be delegated to an institution in a country with equivalent legislation and records are kept off-site, the information must be made available to CIMA, the FIU, or other authorities upon request. In practice, CIMA requires a 10-day turn around period for documents that are to be provided in response to an overseas request.

CIMA has full access to all records during on-site inspections of FSPs. In addition, based on discussions with industry, FSPs' compliance officers and MLRO and external auditors have full access to all records during reviews and audits.

Insurance: The GN specifically require insurance providers to maintain financial statements, copies of direct write policies, reinsurance agreements, policy registers, and loss runs. The number of captives writing life insurance and annuities is small; one captive (insurance manager) indicated that it does not maintain details of the claim settlement including discharge documentation; however, the insurance law provides CIMA with full access to this information and documents may be obtained, despite location of documents.

Securities: The GN contain a separate section on Mutual Fund Administration and Mutual Funds and allow records to be maintained in countries with equivalent legislation (i.e., Schedule 3 country); although industry representatives maintain that internal policies require all KYC documents to be maintained in-house.

Company Managers: The GN have generally provisions regarding the types of records to be maintained by company service providers; in addition, record-keeping procedures and the company service provider's the inspection manual requires institutions to maintain records such that a client's transactions can be isolated, the nature of the transaction identified, where it took place and the form.

Analysis of Effectiveness

Legal and Institutional

Type of documents: Initial customer identification records and transaction records are fully covered by the requirements in place. There is no specific requirement extending the five-year period to records relating to the account or relationship generated after the opening of the account or commencement of the business relationship (other than individual transaction records) such as business correspondence, account files (other than transaction records), or documentation on re-verification of customer identity, although in practice such documents are maintained for the appropriate period.

Exemptions: Under FATF recommendations, a financial institution should have, at least, ready access to a copy of the documents that prove the identity of its customer. The CI regulation does allow that where it is not practicable to comply, it will be enough to provide sufficient information to enable the identity information to be re-obtained.

Enforceability: As it occurs with the other AML mechanisms, regulated institutions are not clearly obliged to **maintain** records but just to "have record keeping procedures."

Implementation

FSPs have adopted appropriate record keeping policies. In practice, FSPs are either maintaining all records in house or are able to obtain relevant information in a reasonable time (including beneficial ownership information and information regarding client's financial flows). Some institutions have imposed strict turnaround times for receiving information from their offices abroad (e.g., three day turnaround). This appears to be working in practice.

Recommendations and Comments

- Amend the record-keeping obligation that record keeping procedures be in place with an obligation to keep identification and transaction records.

- Provide for retention for at least 5 years after the end of the business relationship of account files and business correspondence.

- Provide as a minimum a requirement that there be ready access to a copy of the identity documents.

- Enhance GN in insurance sector section to address additional recordkeeping requirements, including introduced business and discharge documents. Specify that records must be "readily accessible."

Implications for compliance with FATF Recommendation 12

12. Largely compliant (lack of requirement on business correspondence and related records; lack of requirement to maintain records, with only requirement that there be procedures to maintain).

V—Suspicious transactions reporting

(compliance with Criteria 55-57 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 101-104 for the insurance sector)

Description

Obligation to Report

- Section 27 of the PCCL makes it an offense if a person knows or suspects another is engaged in money laundering, and the information came to him in the course of trade, profession, business or employment and the information is not disclosed to the Reporting Agency as soon as is reasonably practicable. There is an exception for professional legal advisors if the information comes in privileged circumstances. Authorities indicate that suspicion includes the concept of willful blindness.

- Section 47 of MDL makes reporting a defense to the offense of assisting drug traffickers. There is no direct failure to report offense as with the PCCL.

- Section 14 of the MLR provides for a system of internal reporting to an appropriate person (the money laundering reporting officer). There must be procedures identifying a person to whom a report is to be made of information which in the opinion of the person handling the business "gives rise to a knowledge or suspicion that another person is engaged in money laundering."

- For FT, a general duty of disclosure of information is set forth in Section 8, TUNMOTO. Under that provision, relevant institutions (both CIMA and persons taking deposits in the course of carrying on deposit taking business) commit an offence if they know or suspect a person is engaged in FT or committing acts of terrorism and do not disclose their suspicion. Disclosures are not treated as breaches of restrictions imposed by statute or otherwise. Under Section 23 of the TL , there is a duty to disclose beliefs or suspicions regarding FT that come to an individual in the course of trade, profession, business or employment.

Authorities must report

There are reporting duties imposed on supervisory authorities to disclose suspicions of ML, when they obtain any information that leads them to suspect ML while acting in the course of their duties. (MLR, sections 15–16). The disclosure shall not be treated as a breach of any restriction imposed by statute or otherwise. (Section 9(4)).

Reporting officer

Within each relevant financial business, a person must be identified as "the appropriate person" to whom an internal report is to be made of any information that gives rise to knowledge or suspicion that money laundering is taking place. (MLR, Section 14).

Liability protection for reporting

Section 27(4) of the PCCL provides that "[w]here a person discloses to the Reporting Authority, his suspicion or belief that another person is engaged in money laundering or any information or other matter on which that suspicion or belief is based, the disclosure shall not be treated as a breach of any restriction imposed by statute or otherwise."

Under Section 43(3) of the MDL, where a person discloses to the authorities a suspicion or belief or any matter upon which that suspicion or belief is based, the disclosure shall not be treated as a breach of any restriction upon disclosure imposed by contract or by any law.

Section 21F of the PCCL Amendment 2003 (provides that without prejudice to any other provision of the PCCL, where there is a disclosure to the FIU, "the disclosure shall not be treated as a breach of any restriction upon the disclosure of information by any enactment or otherwise and shall not give rise to any civil liability." This provision will apply to disclosures for proceeds or suspected proceeds of any kind of criminal conduct, ML, terrorism or FT.

Tipping-off

Under section 25 of the PCCL a person is guilty of an offence if he knows that an investigation is being or about to be initiated, and he discloses information that is likely to prejudice that investigation or proposed investigation.

It is however not an offence to disclose information or any other matter to a professional legal adviser for the purpose of legal advice nor for a professional legal adviser to disclose any information or other matter to his client or his representative in connection with this advice, unless this is done in view of furthering any criminal purpose.

There does not appear to be a tipping off offence relating to the filing of SARs for drug money laundering, although Section 44(9) of MDL contains a provision making it an offence to tip off relating to production orders and search warrants.

The PCCL (Amendments 2003) provide for compliance with further instructions from the FIU through the provision that the FIU may require the provision of information to clarify or amplify a SAR disclosure. Section 21A(2)(c).

Analysis of Effectiveness

Legal and Institutional

A single standard for the reporting duty (preferably that of knowing or suspecting or having reasonable grounds to know or suspect as set forth in the TL) should replace the different standards now set forth for drug ML, other crimes and FT.

The GN issued by the authorities provide useful information on suspicious transactions, but should be reviewed and further updated for FT (as noted heretofore in Table I, section III.)

The laws and regulations provide reasonably good protection from liability for those persons and institutions that report suspicious transactions to the authorities. The protection from liability for reporting, though it has proved adequate in practice, could be strengthened in several respects to ensure that those connected with the decision to report, not just the person or entity making the report, are protected. Explicit reference to officers and directors and other representatives is considered best practice with respect to these provisions, as well as language such that persons are protected from actions, suits or other proceedings. A provision specifying that the disclosure is not a breach of any restriction and that no action, suit or other proceeding would lie against any financial institution or officer, director, employee or representative of the institution in relation to any action taken in good faith by the institution or person pursuant to the reporting obligation would provide greater protection.

The tipping off offence does not appear to apply if a regulated entity tips-off its client before making any SAR (because there is no investigation yet to prejudice). The offence is applicable to any person, and not only to the regulated institutions.

There does not appear to be a tipping off offence for SARs filings for drug trafficking ML.

Implementation

The GN state that "FSPs must establish written internal procedures for filing SARs" and to appoint a money laundering reporting officer (MLRO) to whom suspicious activity reports must be made by staff. Based upon those interviewed, FSPs are well aware of their duty to report suspicious transactions and are filing SARs with their designated MLRO and the MLRO is reviewing and submitting reports to the FIU, if warranted. In 2002, 433 SARs were filed of which 58 percent were received from banks and trusts; two percent were each received from the insurance and securities sector; nine percent were received from company managers; ten percent from attorneys,

eight percent from CIMA; one percent from money transmitters, two percent from real estate agents, four percent from accountants, and four percent from other. The instructions for filing and samples of internal forms and forms to be filed with the FIU are contained in the GN. In addition, the GN contain a description of certain suspicious transactions that may be conducted in various financial sectors. CIMA's inspection program for AML/CFT compliance also contains a description of situations that may give rise to an FSP filing an SAR.

The compliance officer at CIMA functions as the authority's MLRO and also files suspicious activity reports to the FIU which may surface during the licensing process or on-site inspections. In 2002, eight percent of the SARs submitted to the FIU were submitted by CIMA and to date in 2003, CIMA has submitted 27 SARs to the FIU. The GN echo the PCCL and describe the offence of tipping off and notes that caution must be adopted in determining what may be disclosed to a client in the event that a report is filed.

The GN do not address SAR reporting with respect to FT.

CIMA verifies SAR reporting compliance during its on-site inspections.

Insurance Sector: See comments under section III.

Securities Sector: The GN allow the Mutual Fund or the Mutual Fund Administrator establish various arrangements for reporting suspicious activities which may result in the MLRO, if certain appropriate criteria are met, to be located outside the jurisdiction or outsourced to a third party outside the jurisdiction. While these arrangements may be practical, CIMA should establish a mechanism to ensure that these arrangements are appropriate for the size and complexity of the Mutual Fund or Administrator and to test the implementation of the entities' policies.

Recommendations and Comments

- Consider a single standard for reporting for drug trafficking ML, other crimes, and FT preferably that of knowing or suspecting or having reasonable grounds to know or suspect as set forth in the most recent (TF) legislation.

- Amend the tipping-off offence to make sure that it applies from the moment a person has the suspicion, and not only when there is an investigation or proposed investigation, and provide a tipping off offense for drug trafficking ML.

- Consider strengthening the provision protecting SAR reporting to ensure protection for those connected with the decision to report, and that in addition to the disclosure not constituting a breach of secrecy, that no action, suit or other proceeding would lie against any financial institution or officer, director, employee or representative in relation to any action taken in good faith in making a SAR.

- Consider establishing a mechanism to ensure appropriate arrangements have been established for reporting suspicious transactions by mutual funds and mutual fund administrators and an appropriate mechanism to test compliance with these arrangements.

- Update the GN to require SAR reports related to terrorist financing and refer to the list of terrorists posted on CIMAs website.

Implications for compliance with FATF Recommendations 15, 16, 17, 18, 28

15: Compliant
16: Compliant
17: Materially non-compliant (no tipping off offense for drug ML; tipping off does not apply in period before SAR is forwarded.)
18: Compliant
28: Compliant

VI—Internal controls, Compliance and Audit **(compliance with Criteria 58-61 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 89-92 for the banking sector, criteria 109 and 110 for the insurance sector, and criterion 113 for the securities sector)**
Description
Procedures: Sections 5 and 14 of the MLR prohibit persons in the course of a "relevant financial business" from forming a business relationship or carrying out a one-off transaction unless certain internal procedures are maintained, including: • internal reporting procedures that include designating an employee as the person to receive reports ("the appropriate person") of information giving rise to a knowledge or suspicion of money laundering; • for requiring that any such report be considered along with any other relevant information by the appropriate person to determine whether the report gives rise to such knowledge or suspicion; • whereby the appropriate person shall have reasonable access to other information which may be of assistance to him; • for securing that the information or other matter contained in a report is disclosed by the appropriate person to the Reporting Authority where the appropriate person knows or suspects that a person is engaged in money laundering; • for record-keeping; • for identification; and • such other procedures of internal control and communication appropriate to forestall and prevent money laundering. **Training:** Training must be provided to all employees whose duties include the handling of relevant financial business in (Section 5): • the recognition and handling of transactions which may be or are, being carried out by or on behalf of, a person engaged in money laundering; • the business' internal procedures; • enactments relating to money laundering. The MLR contain no explicit reference to an internal audit function to test the system in order to ensure there is adequate compliance with AML regulations, although the GN address this. The MLR are limited by their terms to AML. **Compliance officer**: Under Section 14 of MLR a person must be identified to whom a report is to be made of any information or other matter which gives rise to a knowledge or suspicion that another person is engaged in money laundering. Under Section 5.2 of the GN, FSPs are expected to appoint a suitably qualified and experienced person to whom suspicious activity reports are made by staff. GN at 5.2 notes that "it is generally expected that the MLRO would be a senior member of the staff…." **Recruitment**: There are no regulations about screening procedures to ensure high standards when hiring all employees. Fit and proper criterion are applied in accordance with sectoral laws to directors and senior officers, and in some instances to others who serve in financial institutions. CIMA assesses the fitness and propriety of the licensee's directors and senior officers, and has regard for such things as person's honesty, integrity, reputation, and competence. (See Table 2, Part VII infra.)

Subsidiaries: There are no regulations or directives about applying the home jurisdiction minimum standards to any branch or subsidiary in a foreign jurisdiction. As the MLR applies to all persons who are licensees under the Banks and Trust Companies Law, and branches are licensees, home jurisdiction minimum standards would apply.

However, under Section 11 of the Banks and Trust Companies Law, licensees incorporated under the Companies Law may not without the prior approval from CIMA open a branch, subsidiary, agency or representative office outside CI.

Analysis of Effectiveness

Legal and Institutional

- Internal mechanisms to assure regulatory compliance set forth in the MLR should include, in addition to those currently provided for, an internal audit. As a matter of practice, it appears many FSPs conduct such audits.

- Compliance officers should not be limited to be "reporting officers," and should be at the management level. In addition to receiving internal reports and making SARs, they should be authorized to recommend internal AML procedures in accordance with the risks at each institution, and should have the responsibility to monitor compliance deficiencies. In practice, institutions generally have compliance officers.

- International standards recommend that compliance officers have adequate rank, be appointed by—and report to—the executive officers of the financial institution.

- Foreign subsidiaries of CI institutions are not required to observe home jurisdiction requirements; although, CIMA could undertake regulatory action against the parent for not conducting business in a fit and proper manner. For foreign branches, although they are required to observe such requirements as they are licensees under the Bank and Trust Companies Law, no guidance is provided on this issue.

- As the MLR are limited by their terms to AML, they cover ML offenses related to certain FT predicate crimes, but do not per se require FSPs to adopt internal controls and procedures to prevent their institutions from being used for FT purposes. The obligation to have AML systems and controls would not require CFT systems and controls in cases where no ML is involved, for instance where the source of funds used for FT is legitimate.

Implementation

The overall compliance culture within Cayman is very strong, including the compliance culture related to AML obligations and the framework for internal controls is adequate. The MLR requires FSPs to maintain internal control procedures and communication as may be appropriate for the purposes of forestalling and preventing money laundering. In addition, the GN emphasize the need to ensure that internal auditing and compliance departments regularly monitor and make recommendations to update the vigilance systems; however, the MLR does not require an internal testing function and the GN do not specifically address the need for FSPs to establish an internal testing function. Specifically, the GN expect FSPs to rely on the MLRO or other compliance officer, occupying senior positions, within the organization to ensure compliance with the regulation and that appropriate policies and procedures have been established within the organization and are being followed. For the larger FSPs, this responsibility lies within the internal audit or compliance department. Internal reviews of AML compliance are being conducted as part of the overall internal audit process and are conducted by in-house internal audit departments, home office internal audit departments, or are outsourced to external auditors.

CIMA reviews the internal auditor's report during its on-site inspection and verifies that the FSP has policies, procedures and practices regarding AML compliance in place and discusses related matters with appropriate personnel, if available. In addition, CIMA reviews the external auditor's reports and management letters and notes any deficiencies identified in this area.

CIMA has issued quality guidelines to banks on internal audit and internal controls and has drafted quality guidelines on internal controls for the insurance industry. These guidelines suggest that the internal audit function be independent and if the licensee chooses to outsource this function, close attention is to be paid to the independence of

the external auditor. CIMA is encouraging its institutions to engage two external auditors to perform the internal and external audit function, respectively. Similar guidelines have not been issued for all industries, however.

The majority of the banking industry is composed of subsidiaries and branches of foreign banking organizations. FSPs in this sector apply the higher standard with respect to their KYC policies, which in some cases is more stringent than Cayman but in other cases, bankers indicated that Cayman guidelines are more stringent in certain areas (e.g., the number of references required for prospective clients; performing additional due diligence; and maintaining customer identification files in-house. With respect to Cayman's foreign branches and subsidiaries, it is unclear whether Cayman's standards are observed; however, Cayman Islands have very few branches and subsidiaries of locally incorporated banks located abroad. Nevertheless, the GN do not address this matter.

Over the past two years, the authorities, the FSPs, and the professional associations have made extensive efforts to educate and train the financial industry on Cayman's AML/CFT obligations. All have received quality internal and external training at home and abroad and many are very active in the international standard setting arena. Specific sector training has also been provided which has focused on potential abuses unique to the industry (e.g., insurance sector). Tools have been developed for the industry to aid in increasing the understanding of ML and FT such as videos and interactive CDs. Training is provided to new employees, operations staff, MLROs, and supervisors and managers. Continuing education is also part of programs within various organizations in the industry. The widespread dissemination of information and knowledge has benefited all participants. The GN sufficiently support these practices and CIMA routinely reviews the amount of training received by employees during its on-site inspections.

Cayman is a very sophisticated financial market and on-going training of the operations and nature of the industries is crucial. Supervisors benefit from understanding the nature of the transactions and activities conducted in the financial industry. It is both the FSP and the supervisor's responsibility to fully understand the nature of the client's business and activities and to know who they are serving so that they may detect unusual or suspicious activity and properly report it.

Recommendations and Comments

- Amend the MLR to include explicit reference to an internal audit function to test the system to ensure a firm's compliance with AML/CFT regulations.
- Require that foreign subsidiaries of CI institutions observe at a minimum home jurisdiction requirements and make clear to foreign branches their obligations through guidance and supervision.
- Ensure there is an adequate compliance officer function, broader than reporting, and that the function is at the management level.
- Ensure, as a supplement to the fit and proper standards, there is a requirement that has adequate screening procedures to ensure high standards when hiring all employees.
- As CFT becomes more fully integrated into legal and institutional framework, address in MLR internal controls, training and audit as they relates to FT.
- To further strengthen the GN and regulations, CIMA should issue guidelines on internal audits and internal controls to each financial sector, and include a reference to the AML/CFT issues in each.
- Tighten internal audit guidelines in general to require outsourced internal auditing engagements to be conducted by an external auditor other than the external auditor responsible for an entity's financial statement audit.
- CIMA should continue its quality training program and incorporate courses addressing specific financial issues.

Implications for compliance with the FATF Recommendations 19, 20

19: Largely Compliant (no requirement for internal audit (guidance only);compliance officer function limited to reporting and not at management level.
20: Materially Non-Compliant (no applicability to foreign subsidiaries of CI institutions or guidance to foreign branches.)

VII—Integrity standards

(compliance with Criteria 62 and 63 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion114 for the securities sector)

Description

CI addresses integrity standards for those holding significant interests or management functions through the underlying regulatory statutes in each sector. These statutes apply to directors, management and shareholding interests in excess of 10 percent.

In considering an application by a financial institution for a license to carry on business, CIMA needs to be satisfied, among other things, of the good character of the applicant or, in the case of a company, the good character of the management and major shareholders of a company. Subsequent appointments of directors, the chief executive officers and senior management of licensed financial institutions also require CIMA approval.

CIMA evaluates directors and senior management of financial institutions subject to prudential supervision for expertise and integrity and there is a review to ensure there is no criminal or adverse regulatory record. Money remitters and currency changers are among those subject to fit and proper tests.

Controls to risk of corporate vehicles

- Bearer shares have been immobilized.
- there is a requirement for financial institutions, including trust and company management providers, to "know their customer" and keep identifying records. The GN suggest that FSPs be alert to the potential for abuse of shell companies, and obtain satisfactory evidence of the identity of the beneficial owners, directors and authorized signatories of such companies. Where the shell company is introduced by a professional intermediary, the FSP should follow the procedures for introduced business set forth in the Notes. Section 3.35 GN.
- Non-profit organizations are required to be licensed and to register under the Companies Law (2003 Second Revision). They are required to maintain a register of members and directors and keep proper books of accounts and minutes of resolutions and proceedings. Licenses are issued by the Governor in Council and once the constitutional documents of the non-profit have been reviewed and approved as having a suitable charitable object, changes may be made only with the approval of the Governor in Council. The GN (sections 3.38-3.43) specifically address applicants for business that are associations not-for-profit and suggest vetting of foreign associations that are not-for-profits.

Analysis of Effectiveness

Legal and Institutional

CIMA applies stringent criteria to determine whether persons are "fit and proper" to act as directors, managers, officers, general partners, promoters, insurance managers or shareholders of licensed entities. A risk-based approach is undertaken and applicants are risk-rated. The test is applied during the application process and as an on-going test in relation to the conduct of the business and its relationship with the authority. CIMA's compliance officer conducts due diligence on officers of licensed entities and "Fit and Propriety" Guidelines and Procedures have been issued. Under the Banking and Trust Law, an approval for an exemption lapses if the director or senior officer becomes bankrupt or is convicted of an offence involving dishonesty. There is a similar provision in the Money Services Law.

Criteria used to determine fitness and propriety of individuals include financial soundness; competence and capability; and honesty, integrity and reputation. Criminal backgrounds, complaints, disciplinary actions, and regulatory judgments are checked; an assessment of technical expertise, professional qualification, experience and training to perform the relevant duties is made; and appropriate credit references are required. In addition, a personal questionnaire must be completed by the applicant for directors, shareholders, managers, officers and ultimate controllers (exercise control of 10 percent or more) which covers all relevant fit and proper matters.

There are some controls in place to address corporate vehicles and non-profits with the immobilization of bearer shares, and the licensing and registration of non-profit organizations as well as guidance to be alert for the potential for abuse of shell companies.

Implementation

CIMA has disapproved a few applicants for various positions who have not met the "fit and proper" criteria.

The GN discuss the uses of shell corporations and other ways to disguise the true owner of entities. FSPs are on alert to the potential abuses of these entities and are requesting the identity of beneficial owners, directors and authorized signatories. In addition, the recent revisions to the GN include a section on non-profit organizations, including charities and the possible abuses associated with these entities.

Recommendations and Comments

Implications for compliance with FATF Recommendation 29

29: Compliant.

VIII—Enforcement powers and sanctions

(compliance with Criteria 64 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 93-96 for the banking sector and criteria 115-117 for the securities sector)

Description

As set forth in section I of this Table (General Framework) the "relevant financial businesses" that are obliged to have AML procedures are, in general, all the financial institutions regulated and licensed by the CIMA (banks, insurers, trust companies, mutual funds, mutual fund administrators, company management and other related activities) plus a list of additional financial businesses.

Under Section 6 of the MAL, CIMA is charged with regulating and supervising all financial services businesses in CI, and specifically with monitoring compliance with the MLR. In performing its regulatory functions, it is charged with endeavouring "to reduce the possibility of financial services businesses or relevant financial business being used for the purpose of money laundering or other crime." It is also charged with performing any other regulatory or supervisory duties that may be imposed on CIMA by any other law.

Under Section 34 of the MAL, CIMA may, after consultation with the private sector and with the approval of the Governor, issue or amend rules or statements of principle or guidance to reduce the risk of financial services business being used for money laundering or other criminal purposes. In the case of rules issued by CIMA, there may be imposition of administrative penalties for breaches, but no penalty is to exceed $1000 dollars. The rules are to establish the procedure and policy for imposing the penalty. Section 34(7) of MAL.

Under each of the regulatory laws, CIMA has powers to take actions in relation to licensees, including revocation of a license, imposition of conditions upon the license, substitution of any director or officer of the licensee, appointment of a person to advise the licensee on the proper conduct of its affairs or to assume control of the licensee's affairs or such other action as it considers necessary. Relevant sections of the regulatory laws include:

- Banks and Trusts Companies Law—Section 14
- Insurance Law—Section 11
- Mutual Funds Law—Sections 30 and 31
- SIBL - Section 16

These may be used as appropriate for an institution's failure to comply with the MLR.

The Monetary Authority has issued Ladder of Compliance Guidelines, to clarify the procedures CIMA will follow in the event of non-compliance by a licensee with all appropriate legislation, regulations and policies. CIMA also plans to incorporate an Enforcement Manual into the Regulatory Handbook, describing its policies and procedures for the exercise of the enforcement actions available to CIMA in the event of non-compliance with regulatory laws.

CIMA has the legal powers to access information including confidential customer information in support of its supervisory powers. Under Section 34(8) of MAL, CIMA may require a regulated person, or any person reasonably believed to have information relevant to an inquiry to provide information or produce documents reasonably required in connection with the exercise of its regulatory functions.

In addition to the regulatory powers and sanctions, powers of enforcement and sanction are also vested in the Attorney General who may institute criminal proceedings under the MLR for violations. Under Section 5(2) of the MLR, those who contravene the regulation are guilty of an offense and liable on summary conviction to a fine of $5000 and upon conviction by indictment to imprisonment for two years and a fine as determined by the court.

Analysis of Effectiveness

Legal and Institutional

The framework for supervisory enforcement powers is adequate except with respect to administrative fines. CIMA has the authority to impose graduated measures for a breach of obligations, from orders to refrain from certain conduct to cancelling of a license, but administrative fines are only possible if a rule has been issued (of which there are none) and the fine is statutorily limited to $1000.

Implementation

CIMA's oversight:

CIMA's oversight mechanism is accomplished through its on-site inspection programs and enforcement actions available under the laws, regulations, and internal guidelines. The on-site inspection programs are conducted by each financial sector supervisory department, which will also handle matters of compliance with laws, regulations, and policies up to a certain level, at which time the Compliance Department takes over.

CIMA conducts on-site inspections of all licensees in relevant financial sectors (banks, trust companies, insurance, mutual fund administrators, and company managers) and the inspections include a review of AML compliance. During the examination CIMA's procedures include:

- assessing the internal control environment including the existence of an internal audit function;
- reviewing the policies and procedures in place and if they are being followed;
- reviewing internal and external auditors reports;
- reviewing the Board of Directors minutes;
- verifying that the AML compliance program has been approved by the Board of Directors or senior management at head office or local;
- assessing compliance with internal and regulatory policies and performing a KYC due diligence review by sampling a number of client files; and
- verifying that proper logs of suspicious activity reports are maintained and reviewing these reports.

The banking and trust supervision department conducted 27 inspections this past year (100 percent coverage of domestic banks); the insurance supervisory department conducted seven on-site inspections of insurance managers between 2001–02 (approximately one-sixth captive insurance business coverage) and 28 inspections of domestic life insurers between 1998–2002 (100 percent coverage); the investments supervisory department conducted 25 inspections of mutual fund administrators in 2003 (50 percent coverage of business); and the fiduciary supervision department conducted 9 inspections of trust companies and 9 inspections of company managers during the past year (approximately one-tenth coverage of business). All inspections included a review of AML compliance.

This past year, inspections have focused on ensuring compliance with the retrospective application of customer identification. Most recommendations emanating from the inspections address incomplete identification or recordkeeping files and specific training needs.

CIMA monitors the recommendations made in connection with its inspections and performs follow up inspections. Progress reports are required to be filed by FSPs indicating status of implementation. CIMA has issued Guidelines, "Ladder of Compliance," (Ladder), which CIMA may follow in the event of non-compliance by a licensee with all appropriate legislation and regulations and policies of the authority. As a result of non-compliance CIMA may issue specific directives, require a special audit or investigation, impose business restrictions or expand existing restrictions. Action beyond Stage 3 is directed to CIMA's compliance department. CIMA has required an external auditor to perform a special investigation related to non-compliance with AML requirements.

Insurance: CIMA conducted seven on-site inspections of insurance managers and four Class A insurance companies in 2002; however, coverage of the captive insurance business was only one-sixth (131/650 captives). The on-site inspection program was suspended in 2003 for full inspections but all focused inspections were carried out. CIMA expects to conduct a risk-based inspection of 13 insurance managers, 76 captives and six Class A insurance companies in 2004.

Securities: CIMA has not inspected any market intermediaries (brokers, managers, advisors) since the deadline for submitting an application for licensing is January 2004; however, the stock exchange has been conducting on-site inspections for member firms based on the U.K. supervisory guidelines. CIMA has conducted approximately 50 inspections of mutual fund administrators.

Company Managers: The Fiduciary Department conducted 18 on-site inspections of trust and company managers this past year and intends to conduct 18 in 2004. This will provide minimal coverage of the industry.

The framework for supervisory enforcement powers is adequate except with respect to administrative fines. CIMA has the authority to impose graduated measures for a breach of obligations, from orders to refrain from certain conduct, to cancelling of a license, but administrative fines are only possible if a rule has been issued (of which there are none) and the fine is statutorily limited to $1000.

Recommendations and Comments

- CIMA should begin to focus more on how FSPs are monitoring their activities and identifying suspicious transactions during the next cycle of on-site inspections.
- CIMA should increase resources to a level that will allow adequate on-site coverage for all sectors.
- Take steps such that CIMA can impose meaningful administrative fines for failures to fulfill AML/CFT obligations in addition to the other administrative measures currently available.

IX—Cooperation between supervisors and other competent authorities

(compliance with Criteria 65-67 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 97-100 for the banking sector and criteria 118-120 for the securities sector)

Description

Cooperation between local supervisors: All financial superintendents are under the umbrella of CIMA, they meet frequently, occupy the same premises and freely share information.

Cooperation with other domestic authorities: The AML Steering Group, which comprises, under the chair of the Attorney General, the heads of supervisory and enforcement authorities (AG, Solicitor General, Financial Secretary,

CIMA, police, and customs) provides a ready means for cooperation in all matters. The Steering Group has been an active overseer of Cayman's AML/CFT program, meeting often and tasking members with many of the legislative and other initiatives that are currently being put into place, for instance the PCCL amendments that address a revised FIU structure. CIMA provides information to the FIU through the SAR process and assists police investigators in the prosecution of criminal offences when warranted.

CIMA provides advice to the FIU and police investigators as needed on the operations and commercial activities of FSPs, including on general matters helpful in analysis of SARs or in conducting investigations. Laws also contain provisions regarding assistance. The gateway for provision of assistance to police authorities as to specific accounts/matters is through the filing of a SAR and through production orders issued by a court in CI. Section 49(2)(a) and (g), MAL.

International cooperation: Under Section 49 (3)–(4) of the MAL, provision is made for the lifting of confidentiality regarding information gathered in the course of duties at CIMA in the case of requests for assistance for overseas regulatory authorities. Requests are considered either routine (requests to allow overseas authority to carry out licensing approvals and fit and proper reviews)) or non-routine (all other matters). (Section 49(11) of MAL). In the case of non-routine requests, CIMA may disclose information "necessary to enable the overseas regulatory authority to exercise regulatory functions including the conduct of civil or administrative investigations and proceedings to enforce laws, regulations and rules administered by the overseas authority" after having provided copies of the request to the Attorney General and the Financial Secretary and considered their advice on whether it is in the public interest to provide the assistance. There may be a requirement regarding willingness to provide reciprocal assistance and must be assurances of safeguards on confidentiality and further use.

Analysis of Effectiveness

Legal and Institutional

The requirement for the advice of the AG and Financial Secretary before the provision of any non-routine assistance to an overseas administrator has the potential to be a barrier to efficient and effective assistance. Although in practice there have been few requests, and authorities indicate those that have come have been handled relatively quickly, with a greater volume of requests and a less efficient administration than the current arrangements on consultation, overseas regulators could find that the assistance needed is not forthcoming in the time needed.

Implementation

CIMA has four regulatory divisions – banking, insurance, investments and fiduciary—which are supported by a Legal Division, a Compliance Division, and a Policy and Research Division. CIMA has a staff complement of 87, which is considered low given the broad range of responsibilities undertaken by CIMA. CIMA is committed to relieving the shortage and has plans to reach a staff of 125 by end 2004. In addition, CIMA is firmly committed to hiring qualified personnel with specific expertise in AML/CFT matters. Many senior staff members have also had direct involvement in the international standard setting process. In addition, serious attention is paid to training and educating all staff members in this area. Staff are active in the international AML/CFT arena, including participation in various working groups established by the Offshore Group of Banking Supervisors and the Basle Committee. Regular attendance at CFATF meetings and various other specific sector professional associations also takes place.

CIMA cooperates well with other domestic competent authorities and the gateways for the exchange of information exist. Gateways for international exchange of information also exist and are being used. Over the past year, CIMA has received 144 routine requests (domestic) and 12 non-routine (international) requests for information and CIMA has responded to eight, while four are pending. In this respect, CIMA, if a direction has been issued, requires a 10-day turnaround time for receiving information from the FSP.

The home country supervisor of entities operating in Cayman have conducted several inspections on-site, including Brazil, Bermuda, the Isle of Man, and the U.K. These inspections included review of AML requirements. Cayman banks have overseas operations in five jurisdictions, (Cyprus, Panama, Isle of Man, British Virgin Islands and St. Martin), and on-site inspections, including a review of AML compliance have also been conducted. CIMA has conducted overseas on-site inspections of foreign institutions operating in Cayman, including Brazil, Central America and Eastern Europe. External auditors from other jurisdictions also conduct audits of FSPs in Cayman and have access to all information.

Privacy of information is maintained under the Confidential Relationships Preservation Law. FSPs and the FIU enjoy

a cooperative working relationship and exchange non-confidential information informally at the request of the FIU. However, other than materials provided as part of a suspicious activity report, currently a production order must be presented in order for the FIU to obtain written documents. The FIU will have access to additional information upon request through amendments to the PCCL, which was assented to post mission in December 2003.
Recommendations and Comments
• Consider authorizing CIMA to provide overseas assistance for non-routine reports without the consultative process; at a minimum, adopt an internal protocol for responses with consultation met through notification and opportunity to comment within a short time frame.
Implications for compliance with FATF Recommendation 26
26. Compliant.

C. Summary Tables of the Assessment

Table 4.3. Ratings of Compliance with FATF Recommendations Requiring Specific Action

FATF Recommendation	**Based on Criteria Rating**	**Rating**
1 – Ratification and implementation of the Vienna Convention	1	Compliant
2 – Secrecy laws consistent with the 40 Recommendations	43	Compliant
3 – Multilateral cooperation and mutual legal assistance in combating ML	34, 36, 38, 40	Compliant
4 – ML a criminal offence (Vienna Convention) based on drug ML and other serious offences.	2	Compliant
5 – Knowing ML activity a criminal offence (Vienna Convention)	4	Compliant
7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	7, 7.3, 8, 9, 10, 11	Largely Compliant
8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions; (e.g., foreign exchange houses)		See answers to 10 to 29
10 – Prohibition of anonymous accounts and implementation of customer identification policies	45, 46, 46.1	Largely Compliant
11 – Obligation to take reasonable measures to obtain information about customer identity	46.1, 47	Compliant
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	52, 53, 54	Largely Compliant
14 – Detection and analysis of unusual large or otherwise suspicious transactions	17.2, 49	Largely Compliant
15 –If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	55	Compliant
16 – Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU	56	Compliant
17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU	57	Materially non-compliant
18 – Compliance with instructions for suspicious transactions reporting	57	Compliant
19 – Internal policies, procedures, controls, audit, and	58, 58.1, 59, 60	Largely compliant

training programs		
20 – AML rules and procedures applied to branches and subsidiaries located abroad	61	Materially Non Compliant
21 – Special attention given to transactions with higher risk countries	50, 50.1	Compliant
26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	66	Compliant
28 – Guidelines for suspicious transactions' detection	17.2, 50.1, 55.2	Compliant
29 – Preventing control of, or significant participation in financial institutions by criminals	62	Compliant
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	22, 22.1, 34	Largely Compliant
33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	34.2, 35.1	Compliant
34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	34, 34.1, 36, 37	Compliant
37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	27, 34, 34.1, 35.2	Compliant
38 – Authority to take expeditious actions in response to foreign countries' requests to identify, freeze, seize and confiscate proceeds or other property	11, 15, 16, 34, 34.1, 35.2, 39	Largely Compliant
40 – ML an extraditable offence	34, 40	Compliant
SR I – Take steps to ratify and implement relevant United Nations instruments	1, 34	Compliant
SR II – Criminalize the FT and terrorist organizations	2.3, 3, 3.1	Compliant
SR III – Freeze and confiscate terrorist assets	7, 7.3, 8, 13	Largely Compliant
SR IV – Report suspicious transactions linked to terrorism	55	Compliant
SR V – provide assistance to other countries' FT investigations	34, 34.1, 37, 40, 41	Largely Compliant
SR VI – impose AML requirements on alternative remittance systems	45, 46, 46.1, 47, 49, 50, 50.1, 52, 53, 54, 55, 56, 57, 58, 58.1, 59, 60, 61, 62	Not rated
SR VII – Strengthen customer identification measures for wire transfers	48, 51	

Table 4.4. Summary of Effectiveness of AML/CFT Efforts for Each Heading

Heading	Assessment of Effectiveness
Criminal Justice Measures and International Cooperation	
I—Criminalization of ML and FT	ML is criminalized broadly in accordance with the Vienna Convention, but inconsistencies between various ML provisions should be addressed as planned. FT is criminalized on the basis of the ICSFT by TUNMOTO and the new TL but the ICSFT has not yet been extended to CI. Though it is not necessary for a person to be convicted of a predicate offence to establish assets as proceeds, level of evidence necessary may have the effect of requiring presentation of nearly the entire case. Offences of ML and FT apply to persons who knowingly engage in activities, and intent element may be inferred from objective circumstances. *Because of the restructuring of the framework of the FRU, a separation will be introduced between the roles of SAR handling and investigation with a view to prosecution. The new framework will provide useful information for the analysis of the SARs by the FIU and the investigation by the RCIP Financial Crime Unit, and at the same time will provide a clear separation of duties between the entities involved, protecting the confidentiality of the information received from the reporting entities.*
II—Confiscation of proceeds of crime or property used to finance terrorism	Confiscation and provisional measures are quite comprehensive, but civil forfeiture provisions should be considered and specific provisions on identification and tracing should be adopted. Updating along the lines of the UK PCA as is occurring will enhance scheme. Confiscation orders are value based. Scheme does not address laundered property separately. Confiscation is clearly mandatory for drug trafficking but could be viewed as permissive for other crimes. The PCCL and MDL have provisions for protection of third party rights. *Extensive records of the amount of money and cases based on PCCL restraints, detected criminal offences, seized assets and confiscated drugs are kept by the various CI authorities but no specific records are kept of those SARs used in police investigations and prosecutions.*
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence the domestic and international levels	FIU, a member of Egmont, is undergoing restructuring but both new and old FIU perform usual functions, have wide access to databases and authority to disseminate information. CIMA has issued guidelines on identifying suspicious transactions, and regular guidance is available. Reporting forms are recommended. Dissemination of SARs to overseas authorities requires AG consent. Administrative sanctions, other than administrative fines, are available for failure to report. *The FIU provides feedback to reporting entities and should continue to provide on a regular basis information based on its experience with SARs. The director of the restructured FIU will need the consent of the Anti Money Laundering steering group before he could enter into agreements or arrangements in writing with other FIUs.*
IV—Law enforcement and prosecution authorities, powers and duties	There are clear designations of responsibility for investigations and investigative tools are available but should be supplemented by specific provisions for account monitoring and tracing. *The new posts at the restructured FIU have to be filled as soon as possible.*
V—International cooperation	MDICL, EPOJ, and other statutes facilitate the provisions of mutual legal assistance together with a network of treaties, conventions and arrangements. Authorities recently addressed an issue regarding the availability of mutual legal assistance at the investigatory stage in non-drug non-US MLAT matters through legislation to extend the MDICL to non-drug trafficking matters. Extradition based upon dual criminality is possible in ML and FT matters to a range of countries because of a wide range of treaties and conventions, and should ICSFT be extended, extradition for FT will become possible to all ICSFT parties. CI is able to extradite its own citizens.

Legal and Institutional Framework for All Financial Institutions	
I—General framework	Statutory provision has been made for the lifting of confidentiality for AML/CFT. There are clear designations of authority for monitoring of preventive measures for AML, but not yet for CFT.
II—Customer identification	Anonymous accounts are forbidden based upon general identification obligations. MLR provide clear requirements regarding customer identification, but requirement is to maintain procedures to identify rather than to conduct identification. Provisions regarding wire transfers currently appear as guidance. FSPs are permitted to rely heavily on third-party due diligence. Specific provisions for market intermediaries have not been incorporated into the GN.
III—Ongoing monitoring of accounts and transactions	FSPs must maintain procedures for the filing of SARs and maintain internal control procedures to forestall and prevent ML. In practice, FSP's appear to have adopted adequate approaches to monitor client activities in line with their customer acceptance policies.
IV—Record keeping	A five year retention period is in place for initial customer identification records and transaction records although the requirement is to have record keeping procedures in place rather than to maintain the records. There is no specific provision relating to post account opening non-transaction records as business correspondence and the MLR permits FSPs to maintain sufficient information to enable re-obtaining identity information. Internal policies of CIMA and FSPs visited support reasonable turnaround document retrieval policies.
V—Suspicious transactions reporting	SARs are required but the standard for reporting varies for drug trafficking ML, other crimes and FT money laundering. Protection for those reporting is reasonably good but could be strengthened, and there are tipping off provisions which could be expanded to extend to the period before actual making of the SAR. In practice, FSPs are well aware of their duty to report suspicious activities and make use of the forms provided in the GN.
VI—Internal controls, compliance and audit	The MLR requires the maintenance of internal procedures for reporting, recordkeeping, and identification as well as training requirements. Internal audit, which occurs in practice and is addressed in GN, is not addressed in the MLR. FSPs are not advised to designate an AML/CFT compliance officer at the management level, but only to designate a MLRO who should be a knowledgeable senior staff person. There are no requirements regarding screening for all employees although fit and proper criteria apply to many and institutions as a matter of practice screen employees. There is no requirement that foreign branches of CI institutions apply home jurisdiction minimum standards.
VII—Integrity standards	There are stringent criteria for fit and proper that apply both at time of licensing and on an ongoing basis. Measures to address shell corporations and not-for-profits include immobilization of bearer shares, guidance regarding potential misuse of corporate vehicles and registration and licensing of not-for-profits.
VIII—Enforcement powers and sanctions	CIMA has full powers of enforcement and sanction, with the exception that it may not currently impose meaningful administrative fines for failures to fulfil AML/CFT obligations.
IX—Co-operation between supervisors and other competent authorities	There is regular and good cooperation among financial superintendents, and between the superintendents and other domestic authorities. While a gateway exists for cooperation with foreign supervisors, there is a legal requirement for the advice of the AG and Financial Secretary before the provision of assistance in any matter other than license approvals or fit and proper reviews. CIMA employs high quality and experienced staff with good knowledge of AML. An increase in staff would allow for greater coverage provided by on-site inspection programs.

Table 4.5. Recommended Action Plan to Improve the Legal and Institutional Framework and to Strengthen the Implementation of AML/CFT Measures in Banking, Insurance, and Securities Sectors

Criminal Justice Measures and International Cooperation	Recommended Action
I—Criminalization of ML and FT	Ensure that following the ratification of the Palermo Convention by the U.K., its application is extended to the CI within a reasonable timeframe. Have the ICSFT extended to CI. Harmonize ML offences with one another and expand the MDL's limited provision regarding acquisition of laundered property. Update the definition of ML in the MLR to include references to the FT money laundering offence. Consider addressing through legislation, the evidentiary burden for establishing that funds are proceeds. *Fill vacancies at the new FIU as soon as possible to enable it to fulfil its duties.*
II—Confiscation of proceeds of crime or property used to finance terrorism	Ensure that under the PCCL a court must always consider whether proceeds exist and confiscate the proceeds. Amend the PCCL to provide specifically for the confiscation of laundered property. Amend the PCCL to provide for a range of powers enabling tracing of proceeds including account monitoring orders as is currently under consideration. Consider civil forfeiture scheme based on the U.K. Proceeds of Crime Act 2002 to recover assets derived from any unlawful conduct in a nonconviction based procedure, subject to ensuring protection of legitimate rights to property. Review FT laws to ensure a full ability to restrain the property of terrorist organizations and persons who finance terrorism. *Keep specific records of the SARs used in police investigations and prosecutions.* *Provide training on the newest trends and typologies discovered by the FIU in the SARs on a more regular basis.*
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	Permit FIU Director to make disclosures of SARs to foreign FIUs without Attorney General consent. Ensure the PCCL as amended permits disclosures to overseas authorities in drug trafficking ML matters. Take actions necessary to make meaningful administrative fines available for failure to report. Add information on identifying FT transactions to GN.

	Provide guidance to the public that all reports go to the FIU notwithstanding provisions of other laws. Permit the FIU or CIMA to mandate (rather than suggest) reporting form and methods. *FIU: continue to provide feedback on a regular basis based on its own experience with SARs and latest trends and typologies, to financial and non- financial entities and law enforcement agencies on ML and FT through news media and/ or forums and at seminars on these topics.* *FIU: create, based on own experience with SARs informational booklets about suspicious patterns used for ML and FT in financial and non-financial entities.* *Provide to FIU on-line access to the company's registry.* *FIU: prepare standard arrangements for MOU to submit for approval to the Steering Group at one of its first meetings.*
IV—Law enforcement and prosecution authorities, powers and duties	*Recruiting of additional staff of the FIU as soon as possible, providing of training to new personnel of the FIU and allocating substantial amount of annual budget to provide on a regular basis information about money laundering and terrorist financing to the financial but also non financial sectors of the economy to raise awareness of the possible misuse by criminals of these sectors. Give feedback frequently to financial service providers about their reports, to financial and non financial sector and law enforcement agencies possible trends and typologies which might be discovered during analysis of report.*
V—International cooperation	Extend to all serious crimes mutual legal assistance at the investigatory stage and the full range of kinds of assistance (as set forth in MDICL). (This occurred on a post-mission basis—January 2004)) Ensure that the ICSFT is extended to the CI within a reasonable time frame. In conjunction with the extension of the MDICL to all serious crimes, ensure assistance is available to the widest range of countries and amend limitations to current list of Vienna Convention countries. Enact provisions that permit identification and tracing of proceeds at foreign request and adequate freeze powers.
Legal and Institutional Framework for Financial Institutions	
I—General framework	Amend the MAL and/or other appropriate laws to designate responsibility for FT. Incorporate guidance regarding the activities of securities brokers, advisors, and managers into the GN.

II—Customer identification	Consider enhancing the GN with respect to customer identification contained in the insurance sector section if claims, commissions, and other monies are paid to persons other than policy holders. Consider revising the eligible introducer's form to require disclosure of controller, beneficial ownership, and to require the introducer to attest to performing proper customer due diligence and that information will be made available upon request without delay. Consider appropriate limitations on the exemption in the MLR from identification requirements applicable to transactions made by, or through other financial businesses, to, for instance, low risk transactions and incorporate into the exemption provision in the MLR that a FSP is ultimately responsible for ensuring adequate due diligence procedures and satisfactory documentary evidence from the introducer. Consider conducting, an AML review of prospective licensees deemed to be "high risk" during the licensing process for securities brokers, advisors, and managers. Make it mandatory that financial businesses verify the identity of their customers, rather than "maintain procedures to identify." Address in a more specific manner the need for renewals of identity if doubts appear. Within the two-year period referred to by FATF, amend relevant laws to require that accurate and meaningful originator information (name, address and account number) on funds transfers to ensure it remains with the transfer throughout the payment chain. As a supplement to the adoption of a mandatory requirement regarding wire transfers, tighten the GN regarding originator information on all wire transfers.
III—Ongoing monitoring of accounts and transactions	Make certain there is clear direction to FSPs to maintain files on all transactions brought to the attention of relevant officers and on other transactions that have been examined as complex or unusual with no visible purpose Impose an obligation on FSPs, consistent with SR VII and at least within the two-year phase in period. to give enhance scrutiny to wire transfers that do not contain complete originator information and provide guidance that encourages compliance on an immediate basis. Enhance GN to encourage insurance providers to be particularly vigilant to the particular risks in the industry such as the use of single premium unit-linked policies, the potential for fraudulent claims, and the reinsurance contracts.
IV—Record keeping	Amend the record-keeping obligation that record keeping procedures be in place with an obligation to keep identification and transaction records. Provide for retention for at least 5 years after the end of the business relationship of business correspondence and post account opening non-transaction records.

	Provide as a minimum a requirement that there be ready access to a copy of the identity documents. Enhance GN in insurance sector section to address additional recordkeeping requirements, including introduced business and discharge documents. Specify that records must be "readily accessible."
V—Suspicious transactions reporting	Consider a single standard for reporting for drug trafficking ML, other crimes and FT, preferably that of knowing or suspecting or having reasonable grounds to know or suspect as set forth in recent (TF) legislation. Amend the tipping-off offence to make sure that it applies from the moment a person has the suspicion, and not only when there is an investigation or proposed investigation, and provide a tipping off offence for drug trafficking ML. Consider strengthening the provision protecting SAR reporting to ensure protection for those connected with the decision to report, and that in addition to the disclosure not constituting a breach of secrecy, that no action, suit or other proceeding would lie against any financial institution or officer, director, employee or representative in relation to any action taken in good faith making a SAR. Have CIMA gain assurance of the existence and identity of each MLRO located outside Cayman with respect to mutual funds registered with the authority.
VI—Internal controls, compliance and audit	Amend the MLR to include explicit reference to an internal audit function to test the system to ensure a firm's compliance with AML/CFT regulations. Require that foreign subsidiaries of CI institutions observe at a minimum home jurisdiction requirements and, for foreign branches, make obligations clear through guidance and supervision Ensure there is an adequate compliance officer function, broader than reporting, and that the function is at the management level. Ensure, as a supplement to the fit and proper standards, there is a requirement for adequate screening procedures to ensure high standards when hiring **all** employees. As CFT becomes more fully integrated into the CI legal and institutional framework, address in MLR internal controls, training and audit as they relates to FT. To further strengthen the GN and regulations, CIMA should issue guidelines on internal audits and internal controls to each financial sector, and include a reference to the AML/CFT issues in each. Tighten internal audit guidelines in general to require outsourced internal auditing engagements to be conducted by an external auditor other than the external auditor responsible for an entity's financial statement audit.

	CIMA should continue its quality training and incorporate courses addressing specific financial issues into its training program.
VII—Integrity standards	
VIII—Enforcement powers and sanctions	CIMA should begin to focus more on how FSPs are monitoring their activities and identifying suspicious transactions during the next cycle of on-site inspections. As resources allow, CIMA should increase its on-site coverage in all sectors. Take steps such that CIMA can impose meaningful administrative fines for failures to fulfil AML/CFT obligations in addition to the other administrative measures currently available.
IX—Co-operation between supervisors and other competent authorities	Consider authorizing CIMA to provide overseas assistance in non-routine requests without the consultative process; at a minimum, adopt an internal protocol for responses with consultation met through notification and opportunity to comment within a short time frame.
Banking Sector based on Sector-Specific Criteria	See above.
II—Customer identification	
III—On-going monitoring of accounts and transactions	
IV—Record keeping	
VI—Internal controls, compliance and audit	
VIII—Enforcement powers and sanctions	
IX—Co-operation between supervisors and other competent authorities	
Insurance Sector based on Sector-Specific Criteria	See above.
II—Customer identification	
III—On-going monitoring of accounts and transactions	
IV—Record keeping	
V—Suspicious transaction reporting	
VI—Internal controls, compliance and audit	
Securities Sector based on Sector-Specific Criteria	See above.
II—Customer identification	
IV—Record keeping	
VI—Internal controls, compliance and audit	
Vii—Integrity standards	
VIII—Enforcement powers and sanctions	
IX—Co-operation between supervisors and other competent authorities	

Authorities' Response to the Assessment

The Attorney General's Chambers and CIMA note that the IMF mission has assessed AML/CFT implementation against the FATF 40 + 8 as 'compliant' or 'largely compliant' for all Recommendations rated, except FATF 17 and 20. The mission's consolidated recommendations comprised in Table 4.5 in the majority of cases are under review or implementation; however, the following specific comments are offered in response to the Table 9 (Vol. I) recommended action plan, with emphasis on FATF 17 and 20 and mission recommendations on which the authorities have some reservations.

FATF 17

The Attorney General's Chambers registers some reservations about the mission's recommendation that the tipping off provisions should apply from the (pre-SAR, per the IMF analysis) stage of *suspicion* rather than when an *investigation* is contemplated or in train. The fact is that *tipping-off* is a criminal offence. One of the central tenets of the criminal law is certainty. It would therefore, it is submitted, be difficult to successfully prosecute someone for tipping off triggered by the existence of a mere suspicion because of the inherent difficulties in identifying exactly at what stage the offence would have been committed. A suspicion might not necessarily trigger an investigation. It can and often remains a mere suspicion. The view is that it is therefore more appropriate to apply the offence in circumstances where an investigation is contemplated or in train.

FATF 20

As the mission noted in its report in connection with FATF 20, there are very few branches or subsidiaries of locally incorporated banks located abroad. Regarding entities for which CIMA is the host supervisor, the Authority receives confirmation from foreign branches that their AML procedures are of an equivalent standard to those in the Cayman Islands.

Other Table 9 (Vol. I) comments

The following comments are offered on the FATF Recommendations referenced below, in respect of which the Cayman Islands received mission assessments of "compliant" or "largely compliant."

With regard to FATF 7, it is submitted that because the PCCL provides for confiscation of the *value* of the laundered property, that not only is this wider in scope than the recommended amendment, it removes any incentive for concealment of the property.

With regard to the recommendations made on customer identification and record-keeping rules (FATF 10–13), the authorities agree with the analysis in volume II of the report which states that *"[i]n practice, the record keeping requirements together with the various access provisions for law enforcement authorities ensure that both customer and transaction records are available to domestic authorities for AML/CFT investigations and prosecution."* Thus the implementation evidence appears to support the authorities' position that the MLRs effectively mandate the intended record-keeping.

It is further noted that each respective regulatory law has a provision whereby CIMA is entitled at all reasonable times to have access*, inter alia,* to such books, records and documents as may be necessary for supervisory purposes.

With regard to FATF 32, it is submitted that the mission recommendation is not fully consistent with the mission findings as recorded in volume II that "*…in current practice onward disclosures occur in a timely manner…"* , so that the requirement to obtain the Attorney General's consent does not actually impede disclosures of SARs to foreign FIUs. As regards the 'potential' for the requirement to be a barrier, the legislation and practice will be kept under review. However, it is noted *en passant* that the consent requirement is not dissimilar to that which obtains under the US Bank Secrecy Act (the BSA) and the US Treasury's regulations implementing the BSA, where certain information cannot be further released, disseminated, disclosed, or transmitted without prior approval of the Secretary of the Treasury or his authorized delegate.

With regard to SR III, terrorist property is defined in s.18 TL as proceeds from the commission of acts of terrorism. The freezing of property under schedule 2, paragraph 5 relates to persons charged with offences under ss 18-22. The offences relate to use of or intended use of property. Theoretically, therefore, if a person is simply in possession of terrorist property which is not intended to be used for terrorism, it is arguable whether such property cannot be subject to restraint. Chambers undertakes to revisit this provision to tighten up the language to cover all eventualities.

Post-mission developments

The Attorney General's Chambers wishes to note two post-mission developments. Firstly, FRA vacancies noted by the mission have been filled, and the FRA is now therefore fully staffed. Secondly, the Cayman Islands Government via the Attorney General requested of the UK in August 2004 that the ICSFT be extended to Cayman Islands.

Table 4.5—Other IMF recommendations not directly related to compliance with the FATF 40 + 8

CIMA proposes to address many of the mission recommendations, inasmuch as they relate to possible changes to the GN, in the Policy, Strategy & Relations sub-committee work programme for 2005.

The following specific comments/clarifications are offered on a few of the mission recommendations:

Regarding the recommendation under *V—Suspicious transaction reporting* that a mechanism to ensure appropriate arrangements have been established for reporting suspicious transactions by mutual funds and mutual fund administrators and an appropriate mechanism to test compliance with these arrangements be considered, it is confirmed that the MLR cover mutual funds and fund administrators and that there is an established on-site programme in place whereby compliance with the necessary procedures can be tested.

Regarding the recommendation under *VI—Internal controls, compliance and audit* that to further strengthen the GN and MLR, CIMA issue guidelines on internal audits and internal controls to each financial sector, and include a reference to the AML/CFT issues in each, it is confirmed that Statements of Guidance have been issued on internal controls for banks, insurance companies and securities investment business and also on internal audit for banks.

On administrative fines (*VIII—Enforcement powers and sanctions*), CIMA is currently developing implementation proposals. It is confirmed that an efficient internal protocol is already in place covering the consultation on non-routine assistance to overseas supervisors *(IX—Cooperation between supervisors and other competent authorities)*.