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To: Members of the Executive Board

From: The Acting Secretary

Subject: **Cayman Islands—Assessment of Financial Sector Supervision and Regulation**

Attached for the **information** of the Executive Directors is a paper on the assessment of financial sector supervision and regulation for the Cayman Islands. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Cayman Islands indicating whether or not they consent to the Fund's publication of this paper.

Questions may be referred to Ms. Psalida, MCM (ext. 35360).

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# INTERNATIONAL MONETARY FUND

## CAYMAN ISLANDS

### ASSESSMENT OF FINANCIAL SECTOR SUPERVISION AND REGULATION

Prepared by the Monetary and Capital Markets Department

Approved by José Viñals

October 2, 2009

This report is based mainly on information obtained during a mission from March 2 to 13, which reviewed developments in the supervisory and regulatory framework since the first Offshore Financial Sector assessment mission in October 2003, and on subsequent consultations with the authorities.

The team members comprised Ms. L Effie Psalida (Head), Mr. Mariano Cortés (both IMF), Mmes Su Hoong Chang (consultant, insurance sector) and Tanis MacLaren (consultant, securities and investment funds), and Mr. Richard Pratt (consultant, banking).

The main findings of the OFC assessment update are:

- Substantial progress has been made in the implementation of the 2003 OFC assessment recommendations, including, importantly, regarding CIMA's independence and resources.
- To strengthen its risk-based approach to supervision, CIMA should conduct formal risk assessments and focus its supervisory efforts more directly on the key risks facing the jurisdiction such as reputational risk. Regarding consolidated supervision, CIMA should formulate a robust framework for supervising licensees cross-sectorally to help prevent regulatory arbitrage or supervisory gaps.
- Formalizing and validating the assumptions underlying CIMA's supervisory approach that relies on overseas supervisors and domestic professionals will strengthen CIMA's reliance approach to supervision, but it does not necessarily mitigate all the risks to the Cayman Islands.
- There is scope for enhancing regulatory reporting and disclosure requirements by financial entities, such as shortening the period for filing required documents; and requiring all insurers to disclose their use of derivatives and similar commitments regularly.

*The AFSSR is a summary report on implementation of the indicated financial sector regulatory standards. It has been developed to help jurisdictions identify and remedy weaknesses in financial sector supervision and regulation. The reviews do not directly assess risks such as those associated with asset quality, markets, or fraud that could affect the soundness of financial systems or individual institutions.*

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## ACRONYMS

AML	Anti-Money Laundering
BCP	Basel Core Principles for Effective Banking Supervision
CFT	Combating the financing of terrorism
CI	Cayman Islands
CIMA	Cayman Islands Monetary Authority
CSX	Cayman Islands Stock Exchange
DNFBP	Designated nonfinancial businesses and professions
EU	European Union
FATF	Financial Action Task Force
GN	Guidance Notes
IAIS	International Association of Insurance Supervisors
ISD	Investment and Securities Division of CIMA
IOSCO	International Organization of Securities Commissions
KYC	Know Your Customer
LEG	IMF Legal Department
OFC	Offshore Financial Center
MAL	Monetary Authority Law (2008 Revision)
MCM	IMF Monetary and Capital Markets Department
MFL	Mutual Funds Law (2007 revision)
MLR	Proceeds of Criminal Conduct Money Laundering Regulations, 2003
NAV	Net Asset Value
SIBL	Securities Investment Business Law (2004 Revision)

## EXECUTIVE SUMMARY

**The 2009 OFC assessment update took place in the context of an ongoing global financial crisis whose aftermath could pose challenges to the Cayman Islands.**

**Substantial progress has been made in the implementation of the 2003 OFC assessment recommendations.** The assessment had noted that the implementation of financial regulation and supervision was broadly in line with international standards. Its main recommendation included increasing the independence and resources of CIMA, formalizing appropriate supervision and discipline enhancing transparency, modernizing the Mutual Funds Law, and the introduction of appropriate solvency requirements for insurers. CIMA has made considerable progress toward implementing cross-sectoral recommendations as well as in the banking and the investment funds and securities areas, but some actions remain to be taken in the insurance area.

**CIMA has adopted a risk-based approach to supervision, but needs to broaden the approach by conducting a full risk assessment.** So far, CIMA's implementation of a methodology to rate individual financial institutions has not been placed in the context of an overall risk assessment that takes account of the unique features the financial system in the Cayman Islands (e.g., very large number of banks without a physical presence; the large number of captive health insurance companies). Thus a system-wide risk assessment by the CIMA Board is recommended. Such an assessment should anchor CIMA's implementation of risk-based supervision, i.e., focus its supervisory regime more directly on the key risks facing the jurisdiction.

**On supervision, CIMA in part relies on the work of overseas supervisors, highly skilled financial service providers, e.g., external auditors, lawyers, insurance managers, and other professionals.** This reliance-based approach may be appropriate provided there is a full understanding of the relevant home and host regulatory systems and all parties have a common understanding of their responsibilities. To this effect, CIMA needs to draw up specific agreements with each home supervisor that make clear which risks are addressed by which supervisor according to whose rules, with the understanding that bilateral agreements do not provide full-proof mitigation of risks to the Cayman Islands. CIMA should also review for consistency the reporting obligations of auditors, actuaries and insurance managers and their legal immunities, and, where necessary, document their expectations of such professionals.

**CIMA has the necessary authority to supervise and enforce the regime but some enhancements might be warranted.** The powers granted to CIMA should be consistent across the various statutes it administers, e.g., on the issuance of compliance orders. To provide a more credible deterrent, increasing the monetary penalties that CIMA has the authority to apply would also be helpful.

**The Cayman Islands’ regulatory framework for the investment funds and securities markets exhibits high levels of implementation of the IOSCO Principles but some enhancements might be warranted.** Implementation of electronic filing of mutual fund reports is an important efficiency and transparency enhancement, but the filing period could usefully be shortened.

**CIMA has initiated a review of its licensing and solvency regimes for insurance companies that could facilitate implementation of more risk-based supervision.** At present, CIMA’s approach to the supervision of all Class B insurers—comprised primarily of captives—has initiated a risk-rating framework. Class B insurers with high risk rating and those placed on a watchlist are monitored more closely. A threshold level is not established for Class B insurers to be regulated as captives. A more calibrated regulatory and supervisory approach that takes into account the wide range of risk profiles of the different types of Class B insurers will strengthen CIMA’s supervision of the sector. An effective implementation of a risk-based solvency regime inter-alia calls for an appropriate regulatory reporting framework, market-consistent valuation of assets and liabilities, appropriate asset concentration and counterparty limits, and suitable forms of capital.

**CIMA has made commendable efforts to strengthen its AML/CFT framework but, as in other financial centers, risks remain.** In particular, guidance notes changes have emphasized the importance of ensuring that introducers have adequate due diligence systems covering all customers, and the ongoing monitoring of customer accounts requirements and the ban on business with shell banks have been recently enshrined in law. There remain risks arising from the legacy of customers accepted before these provisions were brought into effect. CIMA will need to focus on enforcement to ensure that practices are brought rapidly into line with requirements.

**Current levels of staff are considered adequate by CIMA but the implementation of the mission’s recommendations may call for additional resources.** CIMA needs to review periodically the adequacy and quality of its human resources to facilitate the effective implementation of risk-based consolidated supervision. CIMA has emphasized its own commitment and that of the government to providing the resources needed. This is highly encouraging.

**The government, CIMA and the industry need to keep abreast of international developments to ensure that the regulatory regime in the jurisdiction incorporates appropriate elements of international best practice.** CIMA’s continued sharing of information and cooperation with other regulatory authorities is key to the jurisdiction’s continued growth, particularly given the current global context. Recent changes to Cayman legislation on co-operation, MLRs and other supervisory requirements are welcome steps in that regard.

**The mission's main recommendations are presented in Box 1.** The recommendations are generally not time sensitive. These recommendations are broadly consistent with the priorities already identified by the authorities and in most cases where policy action is already under way. More detailed recommendations are presented in Appendix II and elaborated upon in the main text of the report and the relevant technical notes.

### **Box 1. Main Recommendations**

- **Independence.** Strengthen the legislative structure for the independence of CIMA, beginning with passage of the pending draft amendments to MAL.
- **Risk-based approach to supervision.** Conduct formal risk assessment and focus CIMA's supervisory efforts more directly on the key risks facing the jurisdiction such as operational and reputation risk.
- **Reliance model.** Formalize and validate the assumptions underlying CIMA's supervisory approach that relies on the strength of supervision applied elsewhere and the contribution of licensees and other domestic professionals to the oversight of financial intermediaries.
- **Consolidated supervision.** Formulate a robust framework for supervising licensees cross-border and cross-sectorally to help prevent regulatory arbitrage or supervisory gaps.
- **Contingency plans.** Draw up contingency plans to handle the failure of important institutions.
- **Systematic sanctions.** Make CIMA's enforcement powers consistent across all administered legislation and set the monetary penalties high enough to make them effective and dissuasive.
- **Resources/Capacity.** Review the human resource budgeting policy and reassess the process regularly to ensure the continued adequacy and quality of regulatory resources.
- **Best practices.** Monitor international developments to ensure that the regulatory regime in the jurisdiction incorporates elements of international best practice as it evolves.
- **Reporting and disclosure.** Enhance regulatory reporting and disclosure requirements of financial entities.
- **Insurance.** Implement a risk-based solvency regime for the insurance industry.<sup>1</sup>

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<sup>1</sup> A draft Insurance Law has been prepared aiming to address this issue.



## I. INTRODUCTION AND OVERVIEW

1. **The Cayman Islands is a self-governed overseas territory of the U.K., with one of the highest per capita incomes in the Caribbean.** It consists of three islands, Grand Cayman, Cayman Brac, and Little Cayman, with a total land mass of about 100 square miles, and a population of 53,886 (2007 estimate), about 60 percent of whom are Caymanian.<sup>2</sup> It is about 480 miles south of Miami, 180 miles northwest of Jamaica, and 150 miles south of Cuba. Estimated per capita income in 2007 was US\$[43,800].<sup>3</sup>
2. **The main areas of economic activity are financial/business services and tourism.** The Cayman Islands issues its own currency, the Cayman Islands dollar, which is fixed at US\$1.20 in a currency board arrangement. There are no direct taxes. The deficit of the central government was estimated at 5.8 percent of GDP in 2008 with the stock of outstanding central government debt at 15.7 percent of GDP. Moody's sovereign rating for the Cayman Islands is Aa3 (Table 1).<sup>4</sup> The Cayman Islands became an IOSCO member on June 10, 2009 and, on the same day, signed the IOSCO multilateral memorandum of understanding on consultation, co-operation and exchange of information.
3. **The Cayman Islands is a major supplier of cross-border financial services,** particularly in banking, with assets totaling US\$1.7 trillion at end-September 2008, down 11 percent from a year earlier due to the global downsizing of bank assets and downturn in economic activity. It is also one of the largest jurisdictions in terms of the number of captive insurance companies and investment funds (Table 2).

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<sup>2</sup> Source: The Economics and Statistics Office (ESO), Statistical Compendium, 2007

<sup>3</sup> Purchasing power parity estimate. Source: <http://www.cia.gov>,

<sup>4</sup> Source: Moody's Investors Service, Credit Opinion: Cayman Islands, November 2008.

**Table 1. Selected Economic Indicators**

Main export products:		Income share by highest				
GDP per capita (US\$ dollars, 2007)	50,303	10 percent (in percent, 2007)				
Population (mid year 2007, 000s)	53.2	Extreme poverty rate				
Under 5 mortality rate (per thousands, 2007)	8.4	Adult literacy rate (in percent, 2007)				
	2003	2004	2005	2006	2007	2008
(Annual percentage change, unless otherwise indicated)						
<b>National accounts and prices</b>						
Nominal GDP (C1\$)	3.7	5.3	14.3	5.4	5.2	5.9
Real GDP	2.0	0.9	6.5	4.6	2.2	0.6
Consumer price index (period average)	0.6	4.4	7.3	0.8	2.9	5.2
Consumer price index (eop)	0.7	11.1	0.0	1.6	2.4	5.4
<b>Social indicators</b>						
Unemployment rate (in percent)	3.6	4.3	3.5	2.6	3.8	4.0
<b>Public finances--central government</b>						
	(In percent of GDP)					
Primary balance	1.7	-2.0	0.4	3.7	-1.4	-5.3
Total revenues	20.3	19.9	22.2	24.6	24.0	23.0
Primary spending (inc. net lending)	18.7	22.0	21.8	20.8	25.3	28.3
Interest expenditure	0.4	0.4	0.5	0.4	0.4	0.5
Overall balance	1.3	-2.5	-0.1	3.3	-1.8	-5.8
Total public debt	9.0	9.3	9.4	8.6	9.8	15.7
<b>Money and credit</b>						
	(12-month percentage change, unless otherwise indicated)					
Liabilities to private sector (M2)				22.6	-12.9	2.8
Currency in circulation				5.4	4.7	2.0
Deposits				22.9	-13.1	4.5
Net domestic assets of the banking system				9.1	6.1	22.4
Of which: credit to the private sector				9.4	3.5	17.9
M2, in percent of GDP			268.5	312.3	258.7	245.7
<b>Balance of payments</b>						
	(In millions of C.I. dollars)					
Current account						
Merchandise trade balance	-537.3	-704.9	-946.7	-869.5	-860.3	-883.4
Exports	19.5	19.8	48.6	19.2	21.5	18.3
Imports	556.8	724.7	995.3	888.7	881.8	901.7

Source: The Cayman Islands Economic and Statistics Office..

**Table 2. Cayman Islands: Main Features of the Financial Sectors, September 2008**

Investment Funds		Banks		Insurance	
Number of entities	Total assets (US\$ trillions)	Number of entities	Total assets (US\$ billions)	Number of entities	
>9,000	1.8	279	35	777	

Source: Cayman Islands Monetary Authority.

## II. FINDINGS OF THE 2003 OFC ASSESSMENT

4. **The 2003 OFC Assessment noted that the implementation of financial regulation and supervision complied broadly with standards in all the areas assessed.** However, issues related to resources and potential breaches of operational autonomy affected the regulator and, hence, supervision in all sectors.<sup>5</sup> The main recommendations related to increasing the independence and resources of the Cayman Islands Monetary Authority (CIMA); strengthening AML/CFT framework; formalizing appropriate supervision and discipline enhancing transparency; modernizing the Mutual Funds Law; and introducing appropriate solvency requirements for insurers (see Appendix I).

## III. CIMA POWERS, RESOURCES, AND RISK-MANAGEMENT FRAMEWORK

5. **The 2009 OFC assessment update found that CIMA has the necessary authority and resources to supervise and enforce the regime but some enhancements might be warranted.** Consideration might be given to providing additional powers, such as the authority to issue “cease and desist” orders against unauthorized persons carrying on activities that require licensing or to issue compliance orders against authorized persons, that would apply to all sectors supervised by CIMA. To provide an even more credible deterrent, increasing the monetary penalties that CIMA has the authority to apply would also be helpful. As regards resources, the increase of the overall CIMA staff numbers from below 90 at the time of the 2003 assessment to the current level of 142 and a further projected increase for end of June 2009 to 152 goes a long way in addressing the staff shortage identified during the first assessment.

6. **The financial industry that CIMA supervises is large in size but the central risk from financial activities carried on within the jurisdiction appears to be reputational.** CIMA’s supervisory approach relies on the work of domestic external auditors, lawyers and service providers such as mutual fund administrators. It is also based on the expectation that most other service providers are satisfactorily regulated in their home jurisdiction. This reliance-based system may be appropriate if there is a full understanding of the relevant home regulatory systems and all parties have a common understanding of their responsibilities vis-à-vis CIMA’s regulations. The validity of these assumptions however, should be tested periodically.

7. **The Cayman Islands have important elements of an effective crisis management framework, but with room for improvement in some areas.** In particular:

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<sup>5</sup> Those assessments dealt extensively with AML/CFT issues, and did not address financial stability issues.

- The authorities have a range of supervisory tools to address weak institutions and unsound practices, including the power to issue “cease and desist” orders. The management committee of CIMA has the power to compel the Executive Committee of local directors of a financial intermediary to take action to implement supervisory directives in a timely manner.
- At present, there is no LOLR facility available within the confines of the currency board arrangement. The experience in other countries with similar monetary arrangements suggest there is scope for a limited LOLR facility funded by the excess holdings of international reserves, supported by appropriately tailored access criteria.
- There is no deposit insurance fund. Given the magnitude of the bank deposit liability relative to the Cayman Islands GDP and the nature of most of those liabilities, there is no compelling argument to establish one with universal participation. In the future, the authorities could explore options to establish one with participation limited in principle to local banks.
- Resolution tools include the powers to appoint a comptroller and ultimately a liquidator. Although supervisory decisions in this area could be challenged in the courts seeking an injunction, past experience has shown the courts typically deferring to the technical judgments of CIMA in a timely manner.
- Coordination arrangements with home supervisors to deal with distressed institutions and those needing resolution could be further develop by CIMA, by inter-alia becoming an active participant in the supervisory colleges of major financial institutions with operations in the jurisdiction.

Finally, CIMA along with other relevant authorities, both local and foreign, should develop and implement crisis management exercises to hone skills and surface gaps in the framework.

#### IV. BANKING REGULATION AND SUPERVISION

8. **The Cayman Islands banking sector is very large and quite unique in its structure, giving rise to a particular set of risks.** With US\$1.75 trillion in assets, the Cayman Islands is the fifth largest financial center in the world (Table 3). However, over \$1 trillion of these assets consist of accounts in Cayman branches of U.S. banks that hold funds overnight in “sweep” accounts in a way that is profitable as a result of the operation of U.S. regulation. The bulk of the remaining activity consists primarily of booked claims through branches, raising funds for parent banks or other companies in their group, and providing other offshore services, primarily to corporate customers. Of the 278 licensed banks, 208, including the U.S. branches already described, have no physical presence in the

Cayman Islands. The banks, branches and subsidiaries, those with and without physical presence, provide a range of offshore services to corporations and individuals. There are seven banks serving the local population. All but a handful of banks are branches or subsidiaries of banks with head offices elsewhere—the U.S., Canada, elsewhere in the Caribbean, South America, and Europe.

**Table 3. Selected Banking Sector Indicators**

(In millions of U.S. dollars)

	2005	2006	2007	2008
Total assets	1,247,383	1,650,265	1,922,041	1,754,121
O/w total cash items	541,914	629,573	795,903	790,348
Loans and advances ( <i>net of provisions</i> )	470,600	725,754	851,903	709,360
Total liabilities	1,247,560	1,655,154	1,930,016	1,777,025
o/w deposits	1,096,600	1,474,305	1,672,768	1,525,222
Operating income	1,158	1,030	1,207	1,267
Number of banks	301	291	281	278

Source: CIMA.

9. **CIMA has made considerable progress toward implementing the recommendations of the 2003 assessment.** A number of important changes have been made to legislation, rules, statements of guidance and regulations with a view to meeting international standards. There is still some room for strengthening as discussed below.

10. **The priority now is to embark upon a formal risk assessment and to focus CIMA's disciplined and effective banking supervision regime more directly on the key risks facing the jurisdiction.** One of the main changes in the Basel Core Principles (BCPs) that were agreed in 2006 has been the more extensive focus on risk-based supervision. CIMA has adopted a risk-based approach but has focused on introducing a risk rating methodology for the rating of individual banks. A risk-based approach is broader than this and should start from a full assessment of the risks facing the financial sector as a whole. Banks interviewed by the mission referred specifically to money laundering and the presence of banks with no physical presence in the jurisdiction as being important risk factors. Capital, credit risk, liquidity risk and market risk remain important, especially for local banks. But these traditional risks are much less important than reputational risk for many of the banking operations within Cayman Islands at present, which would, if materialized, translate into loss of business. A full risk assessment by the CIMA Board is a vital foundation for a comprehensive risk-based approach.

11. **Having completed a full risk assessment, CIMA should use it to inform its entire supervisory approach.** When conducting analyses of license applications, CIMA's approach is rigorous and comprehensive, but its submissions to the Management

Committee do not, according to the off-site manual, have to address the risks that might be posed by an applicant if it were licensed. The risk rating methodology includes some weightings that are constant regardless of the banks concerned. This standardized weighting approach may not fully reflect the range of different types of business undertaken by Cayman Islands banks. For example, for banks that only operate overnight sweep accounts, the main risk may be operational. For other banks, particularly those with no physical presence, there are risks arising from their remote location, such as a possible risk of abuse of financial services. The number of on-site inspections, especially in home countries, of banks with no physical presence in the Cayman Islands may need to be increased in the light of a full analysis of the risks they pose. Equally important, the statements of guidance issued by CIMA should be reviewed in order to provide more specific guidance on the risks and appropriate mitigation measures germane to the banking sector of the Cayman Islands.<sup>6</sup> In these ways, the risk assessment should affect all areas of the CIMA bank supervisory approach.

**12. Where CIMA relies on other supervisors and regimes, it needs to ensure that all risks are adequately addressed.** In supervising over 200 banks with no physical presence, CIMA inevitably has to rely on the regimes and enforcement mechanisms of others. Some bank supervisors in other countries may have little experience of consolidated supervision in these circumstances. They may not be fully aware of the extent to which CIMA is relying on them, especially where CIMA is expecting such banks to follow its own, rather than its home supervisor's regulations. It is important that CIMA's expectations and those of the home supervisor are aligned. To this effect, CIMA needs to draw up specific agreements with each home supervisor that make clear which risks are addressed by which supervisor according to whose rules, with the understanding that bilateral agreements do not provide full-proof mitigation of risks.

**13. Although CIMA makes commendable efforts to create comprehensive regulations and guidance to prevent money laundering and terrorist financing, this remains a risk.** Any financial center faces a money laundering risk. Offshore centers face a particular heightened risk because of the incorrect but still common assumption that the local authorities are prepared to turn a blind eye to such behavior and the fact that most of the customers are remote from the banks with which they do business. Amendments to the money laundering regulations and guidance have been made in the light of previous recommendations and the current regime is, as a result, now of a good standard. The new BCP methodology places greater emphasis on the supervisor's responsibility to ensure full due diligence is conducted by banks. There have been useful recent changes to the ML guidance notes that emphasize the importance of ensuring that full due diligence is applied to all customers from wherever they have been introduced. The MLR were amended in

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<sup>6</sup> At present, the statements of guidance issued by CIMA are based very closely on publications by the Basel Committee for banking supervision and are at broadly the same level of generality.

2008 inter alia to ban dealings with shell banks, to insist on the appointment of a compliance officer, and to require ongoing monitoring of customer accounts—an essential activity that was previously covered in guidance notes. Given the relatively recent nature of these changes, it is important that CIMA emphasizes, in guidance, inspections and other ways, the importance of the changes, especially customer account monitoring.

14. **Staff resources at the Banking Supervision Department are considered adequate by CIMA but changes to the regime may require further additions.** CIMA has increased BSD staff resources since the last assessment insofar as vacancies have been filled, and CIMA regards the current complement as sufficient. However, post inspection reports can be delayed in some cases as can follow up of recommendations. The mission recommends other changes which may increase the need for staff. CIMA has emphasized its commitment and that of the government to providing the resources needed, and this is highly encouraging.

15. **The changes suggested are intended to assist CIMA in achieving fully effective implementation of its regime.** CIMA staff conduct business in a thorough, disciplined and transparent way. Following on from the recommended risk assessment, it is important that the regime becomes more closely tailored to the risks created in the circumstances of the Cayman Islands, and that CIMA is prepared to take tough decisions. This is a capacity CIMA will need as it moves forward.

## V. INVESTMENTS FUNDS AND SECURITIES

16. **The jurisdiction is home to the largest number of investment funds in the world.** As at the end of 2008, there were 9,231 registered funds (93.5 percent of the total), 510 administered funds (5.2 percent) and 129 licensed funds (1.3 percent) (see Table 4 below). The 2007 Funds Annual Returns indicate that the net assets of funds regulated by CIMA as at the end of 2007 was US\$2,265 billion, of which only US\$29 billion were in licensed funds and so available for sale to the public. Overall, the number of funds authorized by CIMA has more than doubled in the past five years. CIMA attributes the growth to the favorable market conditions during the period and the large amounts of investment capital from institutions and sophisticated investors seeking diversification and absolute returns as well as the overall growth in the alternative investment funds industry globally.

17. **The Cayman Islands regulatory regime is particularly suitable for investment funds designed for sophisticated purchasers because there are few prescriptive rules that would constrain investment policies or strategies.** Instead, the overriding obligation is to make full disclosure to investors, in common with many other jurisdictions' requirements for products for these sophisticated purchasers. As a result, the investment strategies of regulated funds vary widely. At end-2007, the top two investment strategies

were multi-strategy and equity long-short, representing a total of US\$1,371 billion of net assets (or 60 percent of the total).

**Table 4. Cayman Islands Monetary Authority – Investment and Securities Licensees**

	2002	2003	2004	2005	2006	2007	2008
<b>Mutual Fund Law Entities</b>							
Mutual Funds							
Registered	3593	4168	5249	6429	7481	8751	9231
Administered	641	592	616	598	548	543	510
Licensed	52	48	67	79	105	119	129
<b>Total</b>	<b>4286</b>	<b>4808</b>	<b>5932</b>	<b>7106</b>	<b>8134</b>	<b>9413</b>	<b>9870</b>
<b>Mutual Fund Administrators</b>							
Full	85	82	83	87	91	95	102
Restricted	132	103	83	61	57	52	49
Exempted	13	10	7	7	5	5	4
<b>Total</b>	<b>230</b>	<b>195</b>	<b>173</b>	<b>155</b>	<b>153</b>	<b>152</b>	<b>155</b>
<b>Securities Investment Business Law Entities</b>							
Licensees				23	24	24	26
Excluded Persons				1,024	1,362	1,674	2,193

Source: CIMA.

18. **There are 155 licensed fund administrators in the jurisdiction, down from a total of 195 in 2003.** About two-thirds of these (102) are full administrators that may act for an unlimited number of funds.

19. **While the full range of fund administration services may be carried out in the Cayman Islands, in practice many of the key activities are carried out elsewhere.** Local fund administrators tend to act as registrar and transfer agent (RTA), net asset value (NAV) calculation agent and recordkeeping. Sales, distribution, marketing and prime brokerage activities take place in major money centers, such as London or New York. As of the end of 2007, 58 percent of regulated funds investment managers are located in North America (\$1.3 trillion in net assets) and 23 percent are located in Europe (US\$513 billion in net assets).

20. **Much of the mutual fund administration activities are carried on in a limited number of countries.** The majority of all regulated funds' calculation agents are located in Bermuda, the Cayman Islands, Ireland, Luxembourg, and the United States. A total 89 percent of all regulated funds with an aggregate of about US\$2 trillion in net assets under administration (as reported at the end of 2007) have their NAV calculated in these



five jurisdictions. Cayman Islands entities represent 30 percent of the total (US\$682 billion). The majority of all regulated funds' RTA agents are also located in Bermuda, the Cayman Islands, Ireland, the Netherlands Antilles, and the United States for a total 91 percent of all regulated funds, and an aggregate of US\$2.2 trillion in net assets under administration. Cayman Islands entities represent 41 percent of this total (US\$928 billion).

21. **The securities investment business in the Cayman Islands is very much smaller than the investment fund industry.** At the end of 2008 there were 26 licensed firms, 20 of which are banks licensed by CIMA. The authorized activities included broker-dealer services, investment management, advisory services, arranging services, and market-making. Most of these licenses were obtained to facilitate offering a full range of services to existing customers. Very little actual trading or investment management activity takes place in the jurisdiction.

22. **The bulk of registrations under SIBL relate to activities by Excluded Persons.** Of the 2,193 Excluded Persons<sup>7</sup> registered with CIMA as of the end of 2008, most are persons carrying on securities investment business exclusively for institutions or sophisticated investors.

23. **CSX is a relatively small, government-owned exchange, whose primary business is listings.** Currently there are 1575 listings, of which 794 are mutual funds, 62 are Eurobonds, 714 are specialized debt instruments (largely asset backed securities and other structured debt) and 5 equity listings (see Table 5). Trading on the Exchange is a relatively new phenomenon and is very infrequent. In terms of value, US\$1.6 million was traded in 2006, US\$5.8 million in 2007 and US\$1.4 million in 2008. In 2008, there were 80 trades involving 359,431 shares. All but one trade was in one domestic bank that is listed on the CSX. There are six member brokers that must be approved by CSX and licensed by CIMA under SIBL. All of the members are banks or are bank affiliates.

24. **The financial sector is serviced by a sophisticated and well-developed service provider structure.** In particular, the legal and accounting sector has extensive expertise in structuring and supporting the activities in the investments and securities sector. The regulatory regime depends to a significant degree on the professionalism of these service providers. Virtually all industry representatives with whom the IMF team met identified the expertise of these professionals as one of the jurisdiction's competitive advantages.

25. **The government and CIMA have taken action on many of the recommendations of the 2003 assessment.** The recommended regulatory guidance

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<sup>7</sup> An Excluded Person is someone carrying on securities activities as listed on Schedule 4 to SIBL.

instruments have been issued and many of the legislative amendments have been enacted. Certain other recommended legislative amendments have been proposed and are in process.

**Table 5. Cayman Islands Stock Exchange**

	2003	2004	2005	2006	2007	2008
Number of Listed Issues						
Mutual Funds	613	804	923	949	1124	793
Specialist Debt Program	18	16	12	15	15	24
Specialist Debt	72	79	111	293	624	697
Eurobond program	0	0	0	1	1	0
Eurobonds	0	0	3	6	35	58
Derivative warrants Program	1	1	0	0	0	0
Derivative warrants	45	2	0	0	0	0
Domestic equity	1	1	1	1	2	2
International equity	4	4	4	4	4	3
<b>Total</b>	<b>735</b>	<b>890</b>	<b>1042</b>	<b>1253</b>	<b>1789</b>	<b>1553</b>
Market Capitalization (in millions of U.S. dollars)						
Mutual Funds	37,432	48,426	63,869	81,044	99,086	60,495
Specialist Debt	2,937	2,915	5,150	19,819	50,163	80,645
Eurobonds	0	0	3,251	8,567	18,798	25,286
Derivative warrants	1,496	60	0	0	0	0
Domestic equity	122	122	122	193	164	159
International equity	2,630	2,354	2,095	1,894	1,923	1,105
<b>Total</b>	<b>44,617</b>	<b>53,877</b>	<b>74,487</b>	<b>111,517</b>	<b>170,134</b>	<b>167,690</b>

Note: Number of listings does not include programs.

Source: CIMA and CSX.

26. **The regulatory framework for the investment funds and securities market of the Cayman Islands exhibits high levels of implementation of the International Organization of Securities Commission's (IOSCO) Principles.** The Cayman Islands Monetary Authority is operationally independent in its day to day activities and appears to have sufficient resources and authority to carry out its responsibilities in the investment funds and securities areas.

27. **Keeping the regulatory structure that applies to funds sold to sophisticated investors up to best international standards is very important.** There are several international reports that have been published recently relating to promulgating 'best practices for hedge funds', such as the standards published by the Hedge Funds Standards Board and the Guidance on Hedge Fund Issues released by the President's Working Group on Financial Markets. The government of the Islands, CIMA, and industry should continue to monitor these developments and contribute their expertise to the dialogue where possible. Any new standards around which there is significant consensus should be

considered for inclusion in the Cayman's regime—by way of legislation, rule or guidance, as appropriate.

28. **CIMA's ability and willingness to share information and cooperate with other regulatory authorities is key to the jurisdiction's continued growth.** In the current environment, when heightened concerns have been expressed about "secrecy" jurisdictions, it becomes crucial, particularly for an OFC, that continued effort be made to both being cooperative and being seen to be cooperative

29. **Implementation of the annual electronic filing requirements for mutual funds has enhanced both the efficiency of the reporting process and the transparency of the operations of these funds.** E-filing requirements were introduced at the end of 2006, providing extensive disclosure of portfolio holdings and other data. Further, extensive analysis of these data is done and made available to the public through the Investments Statistical Digest that is posted on CIMA's website. However, the Funds Annual Returns (FARs) are only required to be filed six months after the year end, which is a relatively long period of time, particularly as the international trend is to shorter time frames for regulatory reporting.

## VI. INSURANCE REGULATION AND SUPERVISION

30. **The insurance industry in the Cayman Islands comprises two distinct sectors: the domestic market and an international segment.** The domestic market consists of Class A insurers permitted to carry on insurance business in or from the Cayman Islands as well as insurance brokers and agents. The international segment is represented by 777 Class B insurers<sup>8</sup> - 700 captive insurers, 45 *special purpose vehicles (SPVs)*, and 32 open market insurers<sup>9</sup> (Figure 1 and Table 6).

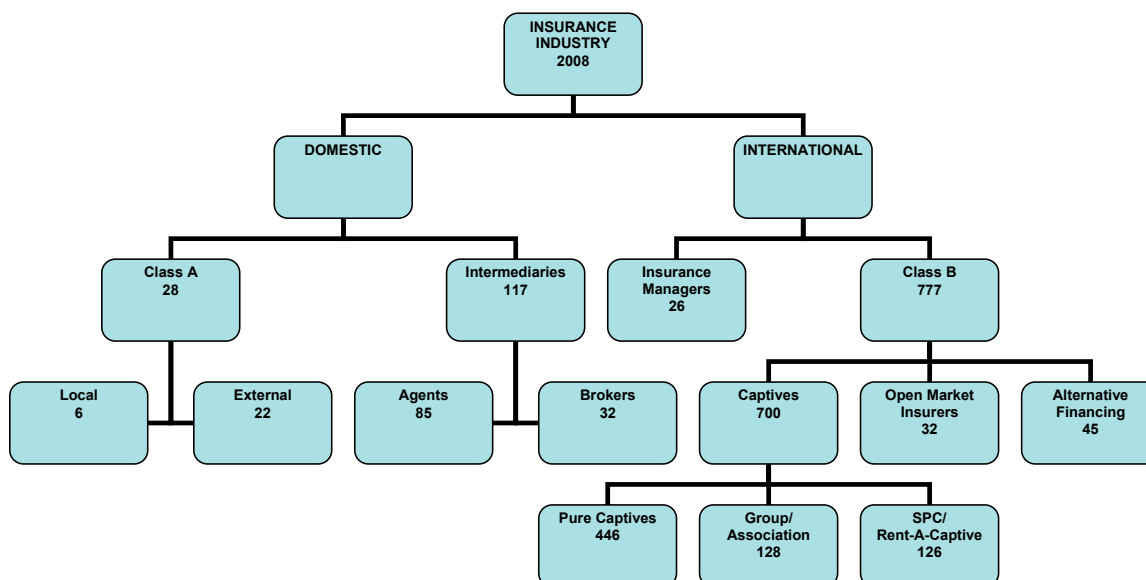
31. **The international segment accounted for more than 99 percent of total assets (US\$ 35 billions) held by the insurance industry** (Table 1). Class B insurers reported *gross written premiums (GWP)* of US\$7.7 billions for 2008 and assets totalling US\$37 billions as at end-2008. Table 7 summarises the relative sizes of Class A and Class B insurers, in terms of total assets and GWP. As there is no restriction on Class A insurers in writing nondomestic risks, the figures reported by Class A insurers may include a small amount of international risk exposures.

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<sup>8</sup> Class B insurers are classified as restricted or unrestricted. Unrestricted Class B insurers are permitted to carry on **non-domestic** insurance business from within the Islands. Restricted Class B insurers write only nondomestic insurance business from its member or members or such persons as may be specifically approved by CIMA.

<sup>9</sup> Open market insurers are licensed to write only foreign risks of unrelated parties (i.e., they are not captives) and they are not permitted to write domestic risks in the Cayman Islands.

**Figure 1. The Structure of the Cayman Islands Insurance Sector as at December 31, 2008**



Source: CIMA

32. **The Cayman Islands is one of the largest captive insurance domiciles in the world.** Of the 700 “captives” as at end-2008, 446 were deemed by CIMA as “pure captives,”<sup>10</sup> 128 were “group/association captives,”<sup>11</sup> and 126 were *segregated portfolio company (SPC)*<sup>12</sup>/rent-a-captives.<sup>13</sup> It is also a leading domicile for the formation of *special purpose vehicles (SPVs)* for catastrophe bonds, with 13 such SPVs licensed by CIMA in 2007.

<sup>10</sup> “Single parent companies writing **only** the risks of their owner and/or affiliates” - IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers.

<sup>11</sup> “Multi-owned insurance companies writing only the risks of their owners and/or affiliates, usually within a specific trade or activity,” IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers.

<sup>12</sup> A segregated portfolio company (SPC) is a single legal entity divided into an unlimited number of cells whose assets and liabilities are legally segregated from each other and from the general assets of the “core” company.

<sup>13</sup> “Insurers specifically formed to provide captive facilities to unrelated bodies for a fee. They are used by entities that prefer not to form their own dedicated captive,” IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers.

**Table 6. Insurance: Number of Regulated Entities**

	End-2003	End-2008	Difference
<b>Class A</b>			
Local	5	6	1
Foreign	22	22	0
Total Class A	27	28	1
<b>Class B</b>			
Pure captives	370	446	76
Group associations captives	114	128	14
SPCs/Rent-a-captive	79	126	47
<i>Segregated cells in SPCs<sup>14</sup></i>	<i>341</i>	<i>509</i>	<i>168</i>
Total captives	563	700	137
Open market insurers	32	32	0
SPVs	18	45	27
Total Class B	613	777	164
<b>Insurance intermediaries</b>			
Insurance managers	25	26	1
Insurance brokers	24	32	8
Insurance agents	66	85	19
<b>Total</b>	<b>755</b>	<b>948</b>	<b>193</b>

Source: CIMA

33. **The domestic market is small, exposed to natural catastrophe, and there is room for consolidation.** Property is the largest class of business (33 percent of total GWP in 2007) followed by casualty, health and workers' compensation (32 percent). Life insurance made up 19 percent of total domestic GWP. Industry feedback suggests that leakage of business to insurers not licensed in the Cayman Islands has dampened the growth of the domestic insurance market. Given the size and population of the Cayman Islands, Class A insurers typically write a small portfolio of policies which tend to be more volatile due to the lack of diversification. Exposures to natural catastrophe as well as the related risks of limited reinsurance capacity and hard pricing was demonstrated by the devastating effects of hurricane Ivan in 2004.<sup>15</sup> Political and regulatory developments in

<sup>14</sup> These are individual cells segregated under a segregated portfolio company, with each cell operating as a stand-alone captive insurer.

<sup>15</sup> At that time, one insurer was intervened by the government.

other jurisdictions may have significant implications for the 22 Class A<sup>16</sup> insurers domiciled outside the Cayman Islands.

34. **The key risks to Class B insurers include changes in the legislative and political climate in their home markets and reputational risk for CIMA.** There has been increased competition from U.S. states that have enacted captive insurance legislation. The role of direct insurers located in other jurisdictions in fronting mandatory insurance to be “reinsured” with captive insurers in the Cayman Islands, hinges on the continued accommodating regulatory stance of their home regulators. Being the home regulator for a large number of insurers that write risks located outside of the Cayman Islands, CIMA’s reputation and credibility vis-à-vis other relevant regulators could be exposed.

35. **Insurers’ investment portfolios and returns have been adversely affected by the current financial crisis.** The steep valuation declines in equity, bond and credit markets and difficulties in accessing credit and other financing arrangements are a regulatory concern for CIMA. Prudential meetings conducted by CIMA suggest that some Class B companies have been affected to some extent by the recent declines in financial markets. CIMA continues to monitor the situation closely.

36. **Insurers operating in the Cayman Islands are well served by a diverse pool of professional service providers.** As at end-2008, there were 26 insurance managers, 32 insurance brokers and 85 insurance agents. Insurance managers are licensed by CIMA to provide professional services to insurers such as captive management. The presence of a sizable pool of professional intermediaries is one of the attractions that have contributed to the development of the Cayman Islands as a leading captive insurance center.

37. **Some of the recommendations for the insurance sector of the 2003 OFC Assessment have been implemented.** CIMA has updated its regulatory regime, and the efficiency of supervision has been enhanced through a formalized regulatory handbook as well as documented checklists and processes (Appendix 1).

38. **The current supervisory approach relies heavily on the work of external auditors, actuaries, and insurance managers.** Given the large number of insurers—which may expose CIMA to reputational risk—it is critical that all stakeholders have a common understanding of and agreement with CIMA’s expectations of their role in the supervisory process. Such understanding and agreement are key elements to ensure that such a reliance-based approach to supervision is appropriate. Thus, given the critical role played by these professionals, CIMA is also advised to review the consistency in the

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<sup>16</sup> The jurisdictions are the United States (6); Trinidad and Tobago (5); Bermuda (4); Bahamas (2), Barbados (1); Canada (1); Guernsey (1); Jamaica (1); and the U.K. (1).

reporting obligations expected of auditors, actuaries and insurance managers and the corresponding legal immunity.

39. **CIMA has initiated a review of its licensing and solvency regimes, which will facilitate a more risk-based approach to insurance supervision.** These regulatory reforms are currently under consideration and consultation with industry. A key consideration for CIMA is to formulate a more calibrated supervisory approach, particularly in respect of the wide range of Class B insurers with diverse risk profiles. CIMA has not adopted the definition of captive insurers used by IAIS<sup>17</sup> which defines captive insurers as those entities that are not part of the insurance/reinsurance groups and whose business from unrelated parties is only a small proportion of the total.<sup>18</sup> It has not defined any threshold level for Class B insurers to be regulated as captives. CIMA has initiated risk assessments of Class B insurers. Class B insurers with a high risk rating are selected for reviews during on-site inspections. CIMA also maintains a watchlist. Insurance managers with Class Bs that obtained a high risk rating or with a significant number of Class Bs on the watchlist are inspected more frequently. Prudential meetings are used and more frequently called for higher rated Class Bs. Moreover, if the risk posed by a Class B increases, CIMA calls for more regular reporting from that entity.

40. **A clear articulation of regulatory objectives that are reflective of the risk profiles of insurers will strengthen further the implementation of a risk-based solvency regime.** Such a regime should be supported by robust corporate governance, market-consistent valuation<sup>19</sup> of assets and liabilities, capital adequacy and enhanced regulatory reporting requirements vis-à-vis both the regulator and the public. The latter will help improved timely surveillance and analysis, and discipline by market forces.<sup>20</sup>

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<sup>17</sup> IAIS defines captive insurers as “an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities, **other than an insurance or reinsurance group entity**, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities and **only a small part if any of its risk exposure is related to providing insurance or reinsurance to other parties.**”

<sup>18</sup> Unrelated parties insured are policyholders of a captive insurer who are not associated by ownership with the owner of the captive insurer.

<sup>19</sup> A risk-based “solvency regime requires a valuation methodology which makes optimal use of and is consistent with information provided by the financial markets and generally available data on insurance technical risks.... In the absence of deep liquid secondary markets that provide sufficiently robust values of insurance obligations, elements of insurance obligations should be valued using cash flow models or other methods that reflect the settlement of the insurance obligations and accord with principles, methodologies and parameters that the market would expect to be used.” The IAIS Common Structure for the Assessment of Insurer Solvency.

<sup>20</sup> A draft insurance law has been prepared aiming to address issues regarding valuation, capital, solvency, and annual return forms.

41. **To ensure effective supervision, CIMA should review regularly the adequacy and quality of its regulatory resources.** The current staffing level of the Insurance Division is not sufficient for robust risk-based supervision which calls for a good understanding of insurers' risks. The high turnover of the Head of the Insurance Supervision Division has significant implications for leadership and continuity. Sound regulatory judgment, backed by practical experience, is essential in exercising risk-based supervision based on clear principles rather than one-size-fits-all rules. Looking forward, CIMA needs to be properly equipped to implement the enhanced solvency requirements and conduct high-quality consolidated supervision.

## VII. ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

42. **A detailed assessment of the anti-money laundering (AML) and combating the financing of terrorism (CFT) framework of the Cayman Islands was conducted in June 2007 and published in December 2007 by the Caribbean Financial Task Force (CFATF).**<sup>21</sup> The assessment was undertaken on the basis of the Financial Action Task Force (FATF) 40+9 Recommendations using the 2004 Methodology.

43. **The Cayman Islands have taken a number of measures over the last years to strengthen their AML/CFT regime.** According to the CFATF assessment report, the Cayman Islands' AML/CFT legal framework is comprehensive, the money laundering offense is in compliance with most of the requirements of the UN Conventions, and the terrorist financing offense is in line with the FATF standard. The Cayman Island financial intelligence unit, the Financial Reporting Authority, is effective and was admitted to the Egmont Group in 2001. Law enforcement and prosecutorial authorities are adequately empowered and competent to investigate and prosecute money laundering and terrorist financing offenses. The system for the confiscation, freezing and seizure of the proceeds of crime is comprehensive and meets most of the standards.

44. **AML/CFT preventive measures apply to the full range of financial institutions envisaged under the FATF standard.** The CFATF report stated that, although measures in place deal with most customer due diligence (CDD) requirements, a number of them have been implemented through guidance rather than through law or regulation as required by the FATF.<sup>22</sup> Some additional shortcomings were identified. In particular, financial institutions are not required to verify that a person acting on behalf of a legal person or arrangement is so authorized, and to identify and verify the identity of this person; they are not required to ensure routinely that CDD documentation and data are kept up-to date;

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<sup>21</sup> The CFATF is the FATF-style regional body of which the Cayman Islands are a member. The assessment was completed within the Board's prescribed 18-month window within which an AML/CFT assessment can be associated with an FSAP or OFC assessment.

<sup>22</sup> See ¶11 for information on relevant changes, including legislative updates.



there is no express requirement for simplified CDD measures to be considered unacceptable in higher risk scenarios; and there are no provisions calling for certain procedures for entering into correspondent banking relationships. Amendments to the Regulations have been made to address these points. CIMA, as the sole regulator of all financial institutions, is responsible for ongoing AML/CFT supervision. Its supervisory regime is comprehensive and meets most of the FATF requirements.

45. At the time of the assessment, all FATF-designated financial businesses and professions (DNFBPs) were included in the AML/CFT framework, with the exception of casinos (which are prohibited) and dealers in precious metals and stones (which were brought into the AML/CFT regime at a later stage). DNFBPs are subject to the same AML/CFT requirements as the financial institutions; the deficiencies noted in the above preventive measures therefore also apply to DNFBPs. However, not all DNFBPs are subject to effective supervision for compliance with AML/CFT requirements.

## VIII. OTHER ISSUES

46. **The private sector pension system is small, with more than 95 percent of employees in the Cayman Islands covered by defined contribution funds.** The Cayman Islands introduced mandatory<sup>23</sup> employer sponsored pension plans in 1998. Total assets of all pension funds were valued at CI\$526 million as at end-2008. The minimum contribution is 10 percent of total earnings, of which contributions from employees should not exceed 5 percent. Currently, six multi-employer plans cover the vast majority of employees. The National Pensions Office (NPO)<sup>24</sup> is the regulator responsible for ensuring the effective and efficient administration of the funds. All plans are subject to strict disclosure requirements and prescriptive investment restrictions.

47. **The NPO faces challenges in enforcing compliance, and a recent review of the pension system recommended significant reforms.** The NPO has to deal with a number of delinquent employers and is hampered by its lean resources<sup>25</sup> and the slow process for enforcement through the judicial system. A review of the pension system conducted in February 2007<sup>26</sup> recommended measures to address the potential shortfall in retirement benefits including: increasing the age of retirement; raising the maximum annual earnings

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<sup>23</sup> Employers are required to contribute for all employees between the ages of 18 and 60 years. Self-employed persons are also required to contribute.

<sup>24</sup> The NPO is currently under the Ministry of Education, Training, Employment, Youth, Sports and Culture.

<sup>25</sup> The NPO has two inspectors, two management members and two clerks.

<sup>26</sup> The review was done by Mercer Human Resource Consulting.

on which an employer must pay pensions, and increasing the minimum contribution rate from 10 to 12 percent.<sup>27</sup>

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<sup>27</sup> <http://www.caycompass.com/cgi-bin/CFPnews.cgi?ID=1029404>

**APPENDIX I. STATUS REPORT AS PER MARCH 2009 ON THE IMPLEMENTATION OF THE  
IMF RECOMMENDATIONS IN CONNECTION WITH THE 2003 OFC ASSESSMENT OF  
THE CAYMAN ISLANDS**

<b>Issue</b>	<b>Recommendation</b>	<b>Status</b>	<b>Remarks</b>
<b>CIMA—Powers and Resources</b>			
Potential for infringement of operational autonomy.	CIMA should be able to issue or amend rules, guidance, etc. without the approval of the Governor in Cabinet as now required by the Monetary Authority Law (MAL) (2003 Revision).	Section 34 MAL has not yet been amended.	MAL amendment to deal with this recommendation approved by Cabinet in March 2009
Staff levels below required and planned numbers and skills.	The current staff deficit suffered by CIMA in all supervisory divisions should be urgently addressed by recruitment and training, as well as outsourcing or secondment from other agencies, as necessary.	Overall, staff has increased by 33% since 2004. Banking complement (25) is unchanged since 2003, ISD staff has more than doubled and insurance staff has increased to 20, but only 16 positions are filled	The current level of staffing in insurance is inadequate for robust risk-based supervision. Banking staff may also need to be increased to meet CIMA's targets for on-site inspections and the recommendations of the mission.
Disincentives for breaches of regulations and rules.	The fine (currently at a maximum of C\$1,000) for breaches of regulations and rules should be sufficiently enhanced to provide a credible deterrent, and improve CIMA's enforcement ability.	No change	Increases in fines to \$5,000 have been included in a MAL amendment bill approved by the Cabinet in March 2009.
<b>Insurance</b>			
Lack of formality of policies and practices.	The practices and policies, while generally of good quality, are too informally laid out. Appropriate supervision and discipline-enhancing transparency require formalization.	CIMA has issued a number of rules, statements of principles and guidance and defined these regulatory instruments in May 2007.	Capital adequacy and solvency requirements are still outlined in a statement of guidance rather than in legally binding regulations. CIMA is in the process of issuing a new Insurance Law, including a margin of solvency regime contained in regulations.
<b>Securities</b>			
Consumer protection.	Detailed consumer protection requirements should be provided for mutual funds open to the public.	New rules introduced for licensed funds (those that may be offered to the public) covering offering document disclosure, segregation of assets and calculation of asset values.	Substantial improvements evident.

Issue	Recommendation	Status	Remarks
Mutual Funds Law.	The provisions of the Law should be brought into line with modern supervisory norms, including, for example, specific inspection powers as in section 16 of SIBL.	New provisions added to the MFL providing detailed powers to CIMA regarding inspections, compliance reviews and authority to revoke approvals of funds and administrators.	Regulatory reporting requirements imposed on authorized entities (funds and MF administrators) could be timelier.
Oversight of the Cayman Islands Stock Exchange (CSX).	The authority for supervision of the CSX should be placed in CIMA, which would replace the current Authority.	No change.	
<b>Cross-Border Cooperation</b>			
The international exchange of non-routine information by CIMA requires consultation with the Attorney General and Financial Secretary.	The authorities should consider removing the requirements that non-routine information be shared only following consultation with the Attorney General and the Financial Secretary. CIMA should have the authority to use its own judgment in sharing information with foreign supervisors. The need to consult has the potential for interference and delays.	The 2008 revision of MAL has removed the requirement to consult the Attorney General. It has also removed the requirement that a recipient authority give a declaration that information will not be disclosed without the approval of CIMA (except where CIMA cannot satisfy itself about the adequacy of a recipient's confidentiality obligation).	The revision appears to have been prompted by the negotiations with IOSCO for acceptance into the MMoU. The removal of the requirement for prior consent for further disclosure is a big step forward. Became a member of IOSCO on June 10, 2009; signed MMoU on March 24, 2009 as a precursor to membership.
Approval of the Governor in Cabinet required for entering into memoranda of understanding (MOUs).	CIMA should be provided with the power to enter into MOUs on its own initiative and authorization, without the need to obtain external approval.	Governor's approval still required under s. 50 of MAL.	MAL amendment Bill approved by Cabinet in March 2009 will remove the requirement for Governor approval.
<b>Anti-Money Laundering</b>		<b>Per CFATF mutual evaluation report dated December 2007</b>	<b>Per CFATF mutual evaluation report dated December 2007</b>
International conventions not extended.	The authorities should ensure that the UN International Convention for the Suppression of the Financing of Terrorism (1999) is extended to the Islands and that the Palermo Convention is also extended following ratification by the U.K.		

Issue	Recommendation	Status	Remarks
Money laundering regulation.	Stricter and more explicit requirements for preventive measures should be adopted in some areas, including internal audit and wire transfers (the last at least within the two-year phase in period), and the compliance officer function should be enhanced.		
Terrorism financing.	Laws relating to terrorism financing should ensure that property belonging to those who finance terrorism can be effectively restrained.		
Provision for reliance on overseas KYC.	Consideration should be given to limiting the broad exemption from identification requirements set forth in the MLR for international business and to strengthening the mechanism with respect to introduced business.		
The international exchange of nonroutine information by the FIU requires the consent of the Attorney General.	The FIU should be able to share SAR information with other FIUs on the basis of the Egmont agreement without prior approval of the AG. <i>The FIU Director should be able to enter into agreements with overseas FIUs without prior consent of AML Steering Group.</i>		

## APPENDIX II. CAYMAN ISLANDS: SUMMARY OF KEY RECOMMENDATIONS

- **Independence.** Strengthen the legislative structure for the independence of CIMA, beginning with passage of the pending draft amendments to MAL. The passage of the Monetary Authority (Amendment) bill will enhance the independence of CIMA.
  - The benefits of regulatory transparency through industry consultations need to be balanced against preserving the independence and credibility of CIMA.
  - The general power to dismiss CIMA directors in the public interest should be replaced with power to dismiss for failure to perform his or her duty as a director in a satisfactory manner. The reason for dismissal should be communicated to the dismissed director.
  - CIMA staff should be given an indemnity to cover the costs of defending any litigation equivalent to the one currently given to directors.
- **Risk-based approach to supervision.** Conduct formal risk assessment and focus CIMA's supervisory efforts more directly on the key risks facing the jurisdiction such as operational and reputation risk.
  - Ensure licensing decisions are made in the full knowledge of the potential risks of the applicant.
  - Formulate clear regulatory policies and a calibrated supervisory approach in respect of Class B insurers that reflect their wide range of risk profiles.
  - Tailor guidance to Cayman Islands conditions.
  - Review on-site inspection program for entities with no physical presence.
- **Reliance model.** Formalize and validate the assumptions underlying CIMA's supervisory approach that relies on the strength of supervision applied elsewhere and the contribution of licensees and other domestic professionals to the oversight of financial intermediaries.
  - Where CIMA relies on other supervisors, have formal agreement with home supervisors on respective obligations; and review MLR Schedule 3 countries in the light of assessments.
  - Establish clear and transparent role of auditors in CIMA's supervisory process and provide appropriate guidance to CISA.
  - Formalize the reporting obligations of auditors and actuaries with appropriate legal immunity.

- Consider clear reporting obligations and legal immunity for insurance managers.
- **Consolidated supervision.** Formulate a robust framework for supervising licensees cross-border and cross-sectorally to help prevent regulatory arbitrage or supervisory gaps.
  - Work closely with other home or host supervisors on maintaining regulatory co-ordination and implementation of a pragmatic and effective regime for group supervision and crisis management.
- **Contingency plans.** Draw up crisis management/contingency plans for the failure of important institutions. CIMA along with other relevant authorities, both local and foreign, should develop and implement crisis management exercises to hone skills and surface gaps in the framework.
- **Systematic sanctions.** Enhance CIMA's enforcement powers and set the monetary penalties high enough to make them effective and dissuasive.
  - Consider examining all relevant statutes to ensure that a wider and proportionate range of authority is provided to CIMA and that the powers are consistent across the various statutes.
  - Provide legal backing for enforcement of the solvency and corporate governance framework for insurance companies by outlining the key principles in the insurance law or regulations.
- **Resources/Capacity.** Review the human resource budgeting policy and reassess the process regularly to ensure the continued adequacy and quality of regulatory resources.
  - Allow for more follow up action regarding on-site inspection recommendations.
- **Best practices.** Monitor international developments to ensure that the regulatory regime in the jurisdiction incorporates appropriate elements of international best practice.
- **Disclosure.** Enhance regulatory reporting and disclosure requirements.
  - Consider shortening time period for filing required documents: investment fund offering documents should be amended more quickly after a material change than the current 21 days, particularly for licensed funds; and the six month filing deadline for audited statements of authorized funds could be shortened.

- Consider requiring licensed mutual fund administrators to file half-yearly unaudited reports.
  - Require all insurers to disclose their use of derivatives and similar commitments regularly.<sup>28</sup>
  - Plan for implementation of the IAIS supervisory standards on public disclosures.
- Implement a risk-based solvency regime for the insurance industry, supported by appropriate regulatory reporting framework, market-consistent valuation of assets and liabilities, appropriate asset concentration and counterparty limits, and suitable forms of capital.
  - Review the maintenance of trust funds by Class A insurers in the light of the risk-based solvency regime.

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<sup>28</sup> The authorities note that at present insurers are required to disclose their investment strategies in their business plans. Moreover, the Statement of Guidance on Asset Management and Investment Strategy for Insurance Companies states that the use of derivatives must be approved by CIMA.