

REGULATORY INTELLIGENCE

COUNTRY UPDATE-Cayman Islands: Securities & Banking

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The Cayman Islands is recognised as a major international financial and banking centre. The Cayman Islands tax neutrality, respected reputation and modern legal structure have all helped to make the jurisdiction the world's leading domicile for offshore investment funds, the second largest captive insurance centre and a world leader in structured finance. It is recognised internationally for its efforts to adhere to international regulatory standards and is a leader in the Caribbean region in the fight against money laundering. The jurisdiction has in place a regulatory regime which surpasses many of the world's top international financial centres.

Cayman's corporate and regulatory regime is based largely on English common law. Consequently, its legal principles are similar to corresponding concepts in the United States and in Canada.

Regulator

The Cayman Islands Monetary Authority (CIMA) is responsible for the regulation and supervision of the financial services industry in the Cayman Islands. CIMA's board of directors comprises up to 10 leading local and overseas individuals who are responsible for operational decision-making, including the licensing and registration of regulated financial businesses that operate in or from the Cayman Islands. The board may delegate any of its duties and functions to committees.

There is (i) an executive committee with responsibility for enforcement decisions (other than matters on which the money laundering reporting officer must report pursuant to the Anti-Money Laundering Regulations); and (ii) a management committee responsible for CIMA's operational decision-making, including considering and determining licensing and registration applications.

There are also two sub-committees of the board (i) the audit and finance sub-committee which assists the board in fulfilling its oversight responsibilities regarding CIMA's financial position and results of operations, including reviewing financial reporting and audit processes and internal controls; and (ii) the Policy, Strategy and Legislative sub-committee which develops and makes recommendations to the board on CIMA's mission, goals and strategic plan as well as new regulatory policies. It also makes recommendations regarding relationships with other regulatory and international organisations and reviews legal, legislative and regulatory matters and developments.

CIMA has four primary functions:

Monetary — The issue and redemption of Cayman Islands currency and the management of currency reserves.

Regulatory — The regulation and supervision of financial services, the monitoring of compliance with money laundering regulations, the issuance of a regulatory handbook on policies and procedures, and the issuance of rules and statements of principle and guidance.

Cooperative — The provision of assistance to overseas regulatory authorities, including the execution of memoranda of understanding to assist with consolidated supervision.

Advisory — The provision of advice to the government on monetary, regulatory and cooperative matters.

Banking regulation

The Monetary Authority Law and the Banks and Trust Companies Law provide the legal framework for banking supervision in the Cayman Islands. The Banks and Trust Companies Law governs the operation of banks and trust companies. Under this law, it is an offence to conduct banking business or trust business without the appropriate licence. The other relevant regulatory laws include the Cooperative Societies Law, the Building Societies Law and the Money Services Law.

Licensees are also subject to the provisions of an array of other local laws, which include the Proceeds of Crime Law, the Confidential Information Disclosure Law, the Anti-Money Laundering Regulations and other CIMA-issued rules, statements of guidance and policies.



In the Cayman Islands, all banking and related activities fall under the regulatory oversight of CIMA. Its banking division is responsible for processing applications for licences and making recommendations to CIMA's management committee on the issue (or non-issue) of a licence. The banking division is also responsible for the continuous supervision and regulation of the activities of banks, money service business providers, building societies and credit unions through, for example, receipt and analysis of regular audited and unaudited financial statements, meetings with bank management, and periodic detailed reports, onsite inspections or auditors' examinations on specific areas of internal controls and systems.

Capital adequacy, asset quality, management capability and expertise, earnings and liquidity of all banks are assessed on a continuing basis.

CIMA is implementing the Basel II Framework, which is intended to promote a more forward looking approach to capital supervision and encourages banks to identify risks and develop or improve their ability to manage those risks. The Basel II Framework applies to banks that are locally incorporated in the Cayman Islands (category A and B banks), all foreign regulated banks and subsidiaries of foreign banks with or without a physical presence. Branches of foreign banks operating in the Cayman Islands are not required to maintain a separate capital requirement and are excluded from the local Basel II requirements. However, they must maintain the minimum capital adequacy requirements of their home jurisdictions. CIMA has implemented a comprehensive liquidity risk management framework for banks as a component of the Basel III Framework. Leverage ratio rules and guidelines will also be implemented under the Basel III Framework later in the year.

CIMA also participates in and is affiliated with several important groups and organisations worldwide, including: the Offshore Group of Banking Supervisors, the Caribbean Group of Banking Supervisors and the Association of Supervisors of Banks of the Americas. Through these groups CIMA has established a vital link to the Basel Committee on banking supervision.

Categories of banking licence

The three categories of banking licence are:

1. An "A" banking licence — this permits domestic business with residents of Cayman as well as offshore business. Relatively few Class A licences are issued.
2. A "B" banking licence — this permits only offshore business. The offshore business may be conducted from offices in Cayman although that is not a requirement. Most banking licences are of this category.
3. A restricted "B" banking licence — this is subject to the same limitation as an unrestricted "B" banking licence (see above) but in addition the licensee is severely restricted as to the customers from whom it may solicit or receive funds. At the licensing stage, a list of customers must be agreed with CIMA, which will not normally permit a list of more than six names. Restrictions may also be imposed on the use of funds.

Specifically, the holder of a "B" licence shall not:

- take deposits from any person resident in Cayman, other than another licensee, or an exempted or an ordinary non-resident company which is not carrying on business in the Islands; or
- invest in any asset which represents a claim on any person resident in the Islands, except a claim resulting from a loan to an exempted or an ordinary non-resident company not carrying on business in the Islands; or
- a loan by way of mortgage to a member of its staff or to a person possessing or being deemed to possess Caymanian status under the Immigration Law, for the purchase or construction of a residence in the Islands to be owner-occupied; or
- a transaction with another licensee; or
- the purchase of bonds or other securities issued by the Government, a body incorporated by statute, or a company in which the government is the sole or majority beneficial owner, without the written approval of CIMA.

CIMA requires a level of net worth appropriate to the scale and nature of the business to be conducted. However, there are statutory minima. For an "A" banking licence, a "B" banking licence and a trust licence the minimum is C\$400,000 (approximately \$480,000). For a restricted "B" banking licence and a restricted trust licence the minimum is C\$20,000 (approximately \$24,000) or, where third party funding / liabilities are involved an amount necessary to satisfy a risk adjusted return of 15% in the case of non-bank or unconsolidated bank subsidiaries, or 12% in the case of bank subsidiaries.

For related operations or where there is 100% related funding, the risk adjusted return based capital requirement can be waived by CIMA if there is confirmation from all depositors/creditors that they are aware that the normal capital adequacy and lending guidelines will not be applied to the operations of the bank.

Local banks are generally capitalised with cash paid for equity shares. Subject to the Basel Committee's rules and guidelines alternative methods of capitalisation may be approved in particular cases. Parent company guarantees are not acceptable as a substitute for capital. Bearer shares are not permitted.

To assist CIMA in assessing the appropriate net worth requirement, local company applicants are required to provide projected financial statements for their first two years of operation.

The required net worth must be maintained at all times. The statutory definition of "net worth" is: excess assets over liabilities as presented under applicable generally accepted accounting principles subject to adjustments for non-admitted assets as determined by CIMA. The various laws of the Cayman Islands gives CIMA a range of powers. It is beyond the scope of this memorandum to deal



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with this, but in broad terms the powers are designed to: (i) give CIMA full access to documents and information when needed; and (ii) to enable appropriate remedial actions to be taken if a licensee is in difficulty or default or is conducting business in an unacceptable manner.

Surrender and revocation of licence

The above mentioned laws set out the circumstances under which a licence may be surrendered by the licensee and the grounds upon which a licence may be revoked by CIMA. The grounds for revocation include the belief by CIMA that a licensee is carrying on business in a manner detrimental to the public interest.

Economic Substance Law

The International Tax Co-Operation (Economic Substance) Law (ES Law) came into force on January 1, 2019 in response to concerns raised by the EU Code of Conduct Group and aims to strengthen economic substance in corporate structures. The ES Law requires "relevant entities" carrying on "relevant activities" to report on those activities on an annual basis and to have "adequate substance" in the Cayman Islands. The definition of a relevant entity includes exempted companies, foreign companies registered in Cayman, limited liability companies and limited liability partnerships. However, investment funds, domestic companies and entities that are tax resident outside the Cayman Islands are excluded.

Relevant entities are required to meet the economic substance test in respect of their relevant activities in the Cayman Islands. Categories of relevant activities include the following businesses:

- banking;
- distribution and service centre;
- financing and leasing;
- fund management;
- headquarters;
- holding company;
- insurance;
- intellectual property; and
- shipping.

Relevant entities carrying on relevant activities must: (i) conduct Cayman Islands core income generating activities (CIGAs) in relation to the relevant activity; (ii) be directed and managed appropriately in the Cayman Islands related to the relevant activity; and (iii) with regard to the level of relevant income from the relevant activity carried out in the Cayman Islands, have an adequate (a) amount of operating expenditure incurred in the Cayman Islands; (b) physical presence in the Cayman Islands; and (c) number of full-time employees or other personnel with appropriate qualifications in the Cayman Islands.

CIGAs are defined as activities that are of central importance to a relevant entity in terms of generating income and that are being carried out in the Cayman Islands. CIGAs may be outsourced provided that the relevant entity is able to monitor and control the carrying out of the CIGA.

Relevant entities in existence prior to January 1, 2019 were required to comply with the ES Law from July 1, 2019. If the relevant entity did not exist at that time, it will be required to comply with the ES Law from the date on which the relevant entity commences a relevant activity.

All Cayman entities with separate legal personality will be required to make an ES Law notification to the Cayman General Registry as a pre-requisite to filing the annual return. All relevant entities, whether or not they conduct any relevant activity, will also be required to make a notification to confirm to the Cayman Islands Tax Information Authority (TIA) whether or not they conduct a relevant activity. Relevant entities conducting relevant activities will be required to report certain information in respect of their relevant activities to the TIA on an annual basis. The first such annual report will be due no later than 12 months after the last day of the relevant entity's financial year commencing on or after January 1, 2019.

Significant civic penalties of up to CI\$100,000 (\$121,950) are prescribed for non-compliance with the ES Law and continuing non-compliance may result in the TIA applying for a court order that the entity is defunct.

Confidentiality

Confidentiality of customers' affairs in the Cayman Islands is required by common law rules of implied contract (the leading English case being *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461) and by specific legislation (the Confidential Information Disclosure Law (2016 Revision)) (CIDL). Rather than imposing a blanket ban on disclosure of information, the CIDL applies to prohibit disclosure of confidential information where a person owes a duty of confidence pursuant to common law.

There are of course appropriate judicial procedures for obtaining the disclosure of information and documents for purposes of either civil or criminal proceedings in the Cayman Islands. If the information or document is confidential, save where excepted, approval for its disclosure or production must first be given by the Grand Court under the CIDL. A person will not be in breach of any duty of confidence if they disclose confidential information in the following circumstances:

- in compliance with directions of a court;



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in the normal course of business or with the consent, express or implied, of the principal;
in compliance with an order or request of a Cayman Islands authority pursuant to various laws enacted to provide assistance or evidence to international jurisdictions;
pursuant to requests by Cayman Islands authorities including the police, the Director of Public Prosecutions, CIMA, the Financial Reporting Authority and the Anti-Corruption Commission; and
in accordance with, or pursuant to, a right or duty created by any other law or regulation (which includes disclosure under the Tax Information Authority Law pursuant to one of the many international tax information agreements Cayman has entered into with participating countries).

As regards the disclosure of information and production of documents for purposes of foreign legal proceedings the Evidence (Proceedings in Other Jurisdictions) Act 1975 of England was extended to the Cayman Islands in 1978, giving the courts of the Cayman Islands discretionary authority to respond to foreign requests for assistance. Claims to privilege (in the Cayman Islands or in the requesting country) are respected. In the case of confidential information or documents it is again necessary for the Grand Court to give approval under the CIDL.

Data Protection Law

The Data Protection Law 2017 (DPL) came into effect on September 30, 2019 and aims to establish a framework of rights and duties to safeguard individuals' personal data in light of the need of public authorities, businesses and organisations to collect and use personal data for legitimate purposes. "Personal data" is defined widely under the DPL and includes any data which enables a living individual to be identified.

The DPL incorporates eight data protection principles which require that personal data must:

- be processed fairly and only when specific conditions are met – for example, where consent has been given, where there is a legal obligation or where it is necessary for the performance of a contract to which the data subject is a party;
- be obtained and processed for one or more specified lawful purposes;
- be adequate, relevant and not excessive in relation to the purpose for which it is collected or processed;
- be accurate and, where necessary, kept up to date;
- not be kept for longer than is necessary for the purpose;
- be processed in accordance with the rights of individuals specified under the DPL;
- be protected by appropriate technical and organisational measures against unauthorised and unlawful processing, and against accidental loss, destruction or damage; and
- not be transferred abroad unless the receiving country ensures an adequate level of protection for the rights and freedoms of data subjects in relation to the processing of personal data.

The provisions of the DPL will apply to any entity established in the Cayman Islands that collects, processes and retains an individual's personal information. Such entities are defined under the DPL as "data controllers" and "data processors". The DPL also applies to data controllers outside of the Cayman Islands that process personal data in the Cayman Islands otherwise than for the purpose of transferring the data. An entity's obligations under the DPL will include informing individuals as to what their personal information is being used for, by whom and for what purposes. Entities are also responsible for personal information processed on their behalf by service providers and third parties.

Under the DPL, individuals may request access to their personal data, request that their personal data is corrected or rectified or request an entity to restrict or cease to process their personal data. Individuals may also seek compensation for damages and certain orders from the Ombudsman in response to contraventions of the DPL.

The Regulation of Securities Investment Business

The duties of CIMA's securities supervision division encompass the supervision and regulation of persons licensed or registered to conduct securities investment business, including market makers, broker-dealers, securities arrangers, securities advisers and securities managers. The securities supervision division processes all applications for those entities specified above and makes recommendations to CIMA's board of directors on the issue (or non-issue) of a licence when necessary.

The Securities Investment Business Law (2020 Revision) (as amended) (SIBL) provides a licensing and registration regime for persons that carry on securities investment business in the Cayman Islands as defined in the law and it is administered by CIMA.

The SIBL contains a wide definition of "securities investment business" which includes, inter alia, carrying on any of the following activities by way of business:

Dealing in securities — buying, selling, subscribing for, or underwriting securities, or offering or agreeing to do so, either as principal or agent. A person will be "dealing" with respect to a particular transaction only if he continuously holds himself out as carrying on that business or the transaction is a result of him continuously soliciting members of the public (e.g. persons other than licensed or exempted persons);

Arranging deals in securities — making arrangements with a view to: (i) another person (whether as a principal or an agent) buying, selling, subscribing for, or underwriting; or (ii) a person who participates in the arrangements of buying, selling, subscribing for or underwriting investments;



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Managing securities — managing securities belonging to another person in circumstances involving the exercise of discretion; and
Investment advice — giving or offering, or agreeing to give, to persons in their capacity as an investor or potential investor, advice on the merits of their buying, selling, subscribing for or underwriting a security, or exercising any right conferred by a security to buy, sell, subscribe for or underwrite a security.

The SIBL defines "securities" in quite broad terms. In addition to items such as shares, bonds and warrants, the definition also includes such things as units in a unit trust, limited partnership interests, debt instruments, options, futures and contracts for differences.

Recent amendments to the SIBL that came into effect on October 31, 2020 provide for circumstances in which virtual assets (e.g. digital currencies) are also considered to be "securities" for the purposes of the SIBL.

There are various exemptions specified in Schedule 2A (being those who are non-registrable persons) and Schedule 3 (being excluded activities) of the SIBL which are not considered to fall within the definition of securities investment business and these exemptions take the person carrying on such activities outside the scope of the SIBL entirely.

SIBL supervision

CIMA is responsible for supervision and enforcement in respect of persons to whom the SIBL applies and the investigation of persons who they reasonably believe to be carrying on or purporting to carry on securities investment business without a licence or without being registered.

Additional offences

The introduction of SIBL also created new offences in the Cayman Islands, these being:

Creation of false or misleading market — a person is guilty of this offence if he creates or does anything which is calculated to create a false or misleading appearance of active trading in any listed securities or with respect to the market for or price of any such securities; and

Insider dealing — subject to various defences available under the SIBL, a person is guilty of the offence of insider dealing if he has information as an insider and he deals, or encourages another person to deal in listed securities that are price-affected securities (meaning that the information, if made public, would be likely to have a significant effect on their value) in relation to the information possessed, or he discloses the information other than in the proper performance of his employment, office or profession, to another person.

A person convicted of either of these offences is liable to a fine of up to CI\$10,000 (approximately US\$12,500) and imprisonment for up to seven years.

Penalties

The SIBL makes it a criminal offence to carry on securities investment business without a licence and provides for a fine of CI\$100,000 (approximately \$125,000) and imprisonment for a term of one year, and in the case of a continuing offence, a fine of CI\$10,000 (approximately \$12,500) per day during which the offence continues.

CIMA's powers under SIBL include (without limitation) the ability to:

- obtain regular returns and conduct on-site inspections in order to determine that a licensee or registered person is in compliance with the SIBL, the Money Laundering Regulations and is otherwise in a sound financial condition;
- revoke the licence or cancel the registration;
- amend, revoke or impose conditions or further conditions upon the licence or registration;
- apply for a court order to protect the interests of clients or creditors including an injunction or restitution or disgorgement order;
- publish breaches in the Cayman Gazette or other official publication;
- require the licensee to obtain an auditor's report on their anti-money laundering systems and procedures;
- require the substitution of any director or officer or the divestment of ownership or control;
- appoint a third party to advise the licensee or registered person on the proper conduct of its affairs and report back to CIMA;
- appoint a person to assume control of the licensee's or registered person's affairs having the powers of a receiver or manager;
- report breaches of the Anti-Money Laundering Regulations to the Director of Public Prosecutions; or
- require such other action to be taken by the licensee or registered person as CIMA reasonably believes necessary.

SIBL and Anti-Money Laundering and Counter Terrorist Financing Compliance

SIBL regulated entities are considered to be carrying on "Relevant Financial Business" as defined in the Proceeds of Crime Law (2020 Revision) (POCL) and are subject to the POCL, the Anti-Money Laundering Regulations (2020 Revision) (regulations) and the guidance notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands (the guidance notes, collectively with the POCL and the regulations, the AML regime) issued by CIMA.

Pursuant to the AML Regime, SIBL regulated entities are required to have internal reporting procedures in place to: (i) identify and report suspicious activity; (ii) monitor and ensure internal compliance with laws relating to money laundering; and (iii) test that their AML system is consistent with the regulations and the guidance notes (together the procedures). As part of the procedures SIBL regulated entities are required to:



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adopt a risk based approach to identify, assess and understand money laundering and terrorist financing risks and clearly document or keep a written record of the risk analysis approach taken;
put in place identification and verification procedures to identify customers and undertake ongoing due diligence measures;
have in place record keeping policies and procedures and due diligence information and ensure that transaction records should be available without delay upon a request by competent authorities;
have internal systems and controls relating to audit function, outsourcing, employee screening and training which is proportionate to the nature, scale and complexity of its activities;
appoint an anti-money laundering compliance officer, to act as compliance officer, who shall have overall responsibility for ensuring compliance by the SIBL regulated entity with the AML Regime; and
appoint a money laundering reporting officer, to act as MLRO and a deputy MLRO, who shall have responsibility for receiving reports of, investigating and reporting suspicious activity in accordance with the guidance notes.

While the ultimate responsibility for maintaining and implementing satisfactory Procedures remains with the SIBL entity, the obligations may be met by delegating or outsourcing those functions, including to persons who are subject to the anti-money laundering requirements of an Anti-Money Laundering Steering Group List country.

Cayman Islands Stock Exchange

In 2001, the Cayman Islands Stock Exchange (CSX) became the first and only offshore exchange to join the Intermarket Surveillance Group, which is an international group of over 50 North American, European, Asian and Australian stock exchanges and regulated bodies committed to the coordination of regulatory efforts across the markets represented.

In 2003, the CSX was approved as an affiliate member of The International Organization of Securities Commissions (IOSCO). IOSCO is the leading international grouping of securities market regulators which develops and promotes important principles and standards in the area of securities regulation to maintain fair, efficient and sound markets. The organisation also promotes the exchange of information and mutual assistance as well as establishing standards for effective surveillance of international markets. Its current membership comprises regulatory bodies from more than 100 countries that have day-to-day responsibility for securities regulation and the administration of securities laws.

In 2004, the UK HM Revenue & Customs granted the CSX its status as a 'recognised stock exchange'. This recognition enables companies whose securities are listed on the CSX to take advantage of the "quoted euro bond exemption." As a result, interest payments on securities listed on the CSX can now be paid without deduction of UK withholding tax. Similarly, securities listed on the CSX are now regarded as "qualifying investments."

Most of the securities held directly in personal equity plans and individual savings accounts must be "qualifying investments." Among the categories of securities a personal pension scheme can hold are securities listed or dealt in on a "recognized stock exchange." Accordingly, CSX-listed securities can now form part of the investments that such personal pension schemes hold.

In 2013 the CSX commenced trading on the Deutsche Börse XETRA trading platform (XETRA). XETRA is the Deutsche Börse's international cash market platform geared for trading of equities, bonds, warrants, exchange traded funds and other financial instruments.

As part of the revision of its listing rules in 2017, the CSX published a new Chapter 14 in connection with listing debt or equity securities issued by 'specialist companies', which is intended to attract listings of securities offered to qualified investors by companies that may be newly incorporated or pass-through SPVs with no specific revenue earning business or companies raising funding for a new project or line of business. This new regime compliments what is already a strong line-up of products that can be listed on the CSX which include: (i) Chapter 6 (Equity Securities); (ii) Chapter 8 (Specialist Debt Securities); (iii) Chapter 9 (Investment Funds); (iv) Chapter 12 (Corporate and Sovereign Debt Securities); and (v) Chapter 14 (Specialist Companies).

The above is a high level overview of certain aspects of anti-money laundering acts and regulations in the Cayman Islands and should not be regarded as comprehensive or as legal advice.

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