

Cayman Islands Monetary Authority

PRIVATE SECTOR CONSULTATION



AMENDMENT TO THE REGULATORY POLICY – EXEMPTION FROM THE AUDIT REQUIREMENT FOR A REGULATED MUTUAL FUND

A. Introduction

1. Section 34(1)(a) of the Monetary Authority Law (2013 Revision) (as amended) (“MAL”) states that –

After private sector consultation and consultation with the Financial Secretary, the Authority may –

- (a) *issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;*
2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

When this Law requires private sector consultation in relation to a proposed measure –

- (a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*
 - i. an explanation of the purpose of the proposed measure;*
 - ii. an explanation of the Authority’s reasons for believing that the proposed measure is compatible with the Authority’s functions and duties under section 6;*
 - iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
 - iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
 - v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3));and*
- (b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations.*

3. The Cayman Islands Monetary Authority ("the Authority" or "CIMA") seeks consultation and comment from the private sector associations concerning the following:
 - a. Amendment to the Regulatory Policy on Exemption from the Audit Requirement for a Regulated Mutual Fund ("Regulatory Policy").
4. While a consultation on a regulatory policy is generally not required by Section 34(1)(a) of the MAL, the Authority believes that the issues presented in this Regulatory Policy will generate significant stakeholder interest. As a result, the decision to conduct a consultation pursuant to Sections 34(1)(a) and 4(1) of the MAL has been taken.

B. Background

5. The Regulatory Policy was issued in its current form in August 2008. The purpose of the Regulatory Policy was to set out clear and transparent criteria under which the Authority will consider waiving the audit requirement or extending the filing deadline for audited accounts for regulated mutual funds, pursuant to section 8(4) of the Mutual Funds Law ("the MFL").
6. Subsequent to industry consultation in November and December 2014, in March 2015 the Authority issued a new Rule on the Cancellation of Licences and Certificates of Registration of Regulated Mutual Funds ("the Rule") as well as a related Regulatory Procedure. On issuance of the Rule and Regulatory Procedure, CIMA received several queries from industry participants with respect to the application and scope of section 7.1 (Additional Information) of the Regulatory Procedure, which states:

"Unless a Fund qualifies for an audit waiver, it must provide audited accounts from the date of the last financial year end (for which audited statements have been filed) either to the date of commencement of the winding up where third party liquidator(s) have been appointed, or the date of the final distribution if no third party liquidator(s) have been appointed".
7. Industry participants queried whether the new section 7.1 superseded the Authority's practice of granting an audit waiver where a fund ceased operations prior to its year end ("stub audit"). The practice granting waivers for stub audits was not documented in the Regulatory Policy. To give the private sector more time to adjust to the new practice relating to stub audits, CIMA postponed the implementation of the Rule and Regulatory Procedure on Cancellation until September 2015.
8. The Authority is now seeking, through on-going discussion and official consultation, to clearly establish its position on partial year audit waivers by more closely aligning its practices with published industry measures, policies and procedures. This will be achieved through the proposed amendment to the Regulatory Policy on Audit Waivers.

C. International Standards

9. The importance of audit requirements for regulated entities has been well established throughout various international standards relating to the banking, insurance, securities industries and trust and corporate service providers (TCSPs). Also of particular relevance to the Cayman Islands is the importance of such requirements for funds pursuant to the alternative investment fund managers

directive (AIFMD). The below table summarises the applicable standards and forms the basis of the Authority's viewpoint that audited financial statements constitute an integral tool of an effective regulatory framework and thus that exemptions from the requirement to produce such statements be limited to exceptional circumstances.

<p>Basel Core Principles (BCPs)</p>	<p><u>BCP 27: Financial Reporting and External Audit</u></p> <p>The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.</p>
<p>Insurance Core Principles (ICPs)</p>	<p><u>Supervisory Reporting</u></p> <p><u>ICP 9.4</u></p> <p>The supervisor establishes documented requirements for the submission of regular qualitative and quantitative information on a timely basis from all insurers licensed in its jurisdiction. Also, the supervisor requires that an external audit opinion is provided on annual financial statements.</p> <p><u>ICP 9.4.1</u></p> <p>The supervisor requires insurers to submit financial reports, which include at least a balance sheet and an income statement (including a statement of comprehensive income if appropriate) and reviews such information on a regular basis.</p> <p><u>ICP 20: Public Disclosure</u></p> <p>Subject to the nature, scale and complexity of an insurer, supervisors require insurers to produce, at least annually, audited financial statements and make them available to market participants.</p>
<p>Objectives and Principles of Securities Regulation</p>	<p><u>Category E: Principles for Issuers</u></p> <p><u>Principle 16</u></p> <p>There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors' decisions.</p> <p><u>Category G: Principles for Collective Investment Schemes</u></p>

	<p><u>Principle 26</u></p> <p>Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor’s interest in the scheme.</p>
<p><i>AIFM Directives</i></p>	<p><u>Article 22: Annual Reports</u></p> <p>An AIFM shall, for each of the EU AIFs it manages and for each of the AIFs it markets in the Union, make available an annual report for each financial year no later than 6 months following the end of the financial year. The annual report shall be provided to investors on request. The annual report shall be made available to the competent authorities of the home Member State of the AIFM, and, where applicable, the home Member State of the Alternative Investment Fund.</p>
<p><i>Standard on the Regulation of Trust and Corporate Service Providers</i></p>	<p><u>Prudential (G) Standard 3: Requirement to have Accounts Audited</u></p> <p>The Regulator should require a TCSP to produce financial statements, in line with the accounting standards applicable in its home jurisdiction, and to have them audited.</p>

D. Purpose of proposed Amendment to Regulatory Policy

10. The Regulatory Policy currently lists several situations in which the Authority would consider exempting a regulated mutual fund from filing annual audited accounts.
11. The purpose of the proposed amendment is to add to the existing list further situations in which a regulated mutual fund can apply to the Authority for an exemption from the audit requirement under section 8(4) of the MFL.
12. Additionally, the amendment to the Regulatory Policy seeks to clarify that the Authority is abandoning its previous practice in relation to granting waivers for stub audits in circumstances other than those described in the Regulatory Policy.
13. The Regulatory Policy will outline the circumstances in which the Authority would generally consider granting an audit waiver. Though the Regulatory Policy indicates that the Authority may consider granting an audit waiver in circumstances not defined therein, those requests will only be granted in exceptional circumstances and at the absolute discretion of the Authority.

E. Proposed Changes to the Regulatory Policy

14. The revised Regulatory Policy, as found in Appendix 1, will include more circumstances under which regulated funds may apply for an exemption of the audit requirement (including associated documentation/information submission requirements). The additional circumstances will include:

- a) Funds being liquidated and a third party liquidator has been appointed under terms which require a review of the period since the last audit;
- b) A fund transferring to another jurisdiction within six (6) months of its last filed audit; or
- c) A fund dissolving by way of a merger within six (6) months of its last filed audit.

15. Furthermore, the Authority’s consideration for audit extensions will also extend beyond situations where a fund has not immediately commenced operations after registration. The Authority may now consider extending a fund’s last audit period for a maximum of 18 months from the date of the last audit conducted.

16. Though these expanded situations will be clearly specified, the Regulatory Policy will incorporate a clause which provides regulatory flexibility. This clause will allow the Authority, in exceptional circumstances, to exercise its absolute discretion in granting audit waivers. Notwithstanding, the revised Regulatory Policy, in conjunction with the Regulatory Procedure on Cancellation, will create the basis for abandonment of the supervisory practice of granting waivers in relation to stub audits.

F. Estimation of significant costs and benefits

17. The table below shows the costs and benefits of the proposed amendment to the Regulatory Policy.

Table 1

	Costs	Benefits
CIMA	<ul style="list-style-type: none"> 1. Conduct consultation. 2. Gazette and publication of new measure. 3. Amend supervisory manuals. 4. Training of ISD’s staff. 	<ul style="list-style-type: none"> 1. Create consistency between industry measures and supervisory practices. 2. Greater regulatory transparency. 3. Reduced risks posed by terminating funds.
Cayman Islands	None	<ul style="list-style-type: none"> 1. Increased protection for investors. 2. Enhanced reputation of the jurisdiction.
Regulated Funds	<ul style="list-style-type: none"> 1. Additional audit costs as a result of the possible need to undertake partial year audits. 	<ul style="list-style-type: none"> 1. Greater clarity on supervisory expectations which will positively aid planning and management by regulated funds.

G. Comments and Consultation

18. The Authority seeks consultation through written comments and representations from the private sector associations concerning

- Amendment to the Regulatory Policy on Exemption from the Audit Requirement for a Regulated Mutual Fund.

19. The Authority must receive representations by 17H00, 8 January 2016.

20. Comments and representations must be addressed to

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21. The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.