



PRIVATE SECTOR CONSULTATION
Rule and Statement of Guidance on
Internal Controls for Regulated Entities

Private Sector Consultation

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A. Introduction

1. Section 34(1)(a) of the Monetary Authority Act (2020 Revision) ("MAA") states that:

After private sector consultation and consultation with the Minister charged with responsibility for Financial Services, 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 MAA 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") seeks consultation and comment from the private sector associations concerning the proposed Rule and Statement of Guidance on Internal Controls for Regulated Entities (attached as Appendix 1).

B. Background

4. In 2007, the Authority issued *Rule on Internal Controls - General for all Licensees* ("the 2007 Rule on Internal Controls"). The 2007 Rule on Internal Controls provides that a licensee must establish, implement, and maintain internal controls, strategies,

policies, and procedures appropriate for the size, complexity, and nature of its activities. It also requires that such controls, strategies, policies, and procedures be approved by the licensee’s board of directors; and be monitored periodically. The Authority also issued various sector specific Statements of Guidance (“SOGs”) to assist licensees in implementing effective internal controls required by the 2007 Rule on Internal Controls.

5. The current Rule and SOGs on internal controls (together referred to as “current measures”) are largely based on the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of Treadway Commission (“COSO”) in 1992 (the “Original Framework”).

Updates to the COSO Integrated Framework

6. In May 2013, COSO issued the revised *Internal Control - Integrated Framework* (the “2013 Framework”). Under the 2013 Framework, the requirement to consider the five components of internal control in assessing the overall effectiveness of internal control remained fundamentally unchanged from the Original Framework. In addition, the 2013 Framework continued to emphasize the usefulness of application of management judgement in designing, implementing, and conducting internal control, and assessing the effectiveness of internal controls. However, it included enhancements regarding changes in business and operating environments occurring since the inception of the Original Framework. These changes include:

- (1) expanded expectations for governance oversight over internal controls;
- (2) increased globalization of markets and operations;
- (3) changes and greater complexities of business operations;
- (4) greater level of demands and complexities in laws, rules, regulations and standards;
- (5) expectations for competencies and accountabilities in respect of internal controls;
- (6) more emphasis on the use of, and reliance on, evolving technologies; and
- (7) increased expectations in relation to preventing and detecting fraud.

Table 1 below provides a summary of the key areas of changes in the 2013 Framework in comparison to the Original Framework.

Table 1: Summary of Changes in the 2013 Framework

Areas remaining the same from the Original Framework:	Changes under the 2013 Framework:
✓ Core definition of internal control.	✓ Changes in business and operating environments considered and incorporated in the framework.
✓ Three categories of internal control objectives and five components of internal control.	✓ Operations and reporting objectives expanded. Additional approaches and examples relevant to operations, compliance, and non-financial reporting objectives added.
✓ Each of the five components of internal control are required for effective internal control.	
✓ Importance of the role of judgment in designing, implementing, and conducting internal control, and in assessing its effectiveness.	✓ Fundamental concepts underlying each of the five components articulated as principles which are also required for effective internal control.

7. The proposed measure is intended to ensure that changes introduced in the 2013 Framework are appropriately incorporated, thereby contributing to strengthening of the internal controls for regulated entities.

Expansion of the Scope of Application

8. The proposed measure is intended to extend the scope of application to all entities supervised by the Authority, including, but not limited to: money service businesses, development banks, credit unions, building societies, mutual funds, private funds, registered persons¹ and virtual asset services providers.
9. The Authority considers that effective internal controls are required for all regulated entities. In general, internal controls represent the way a regulated entity is structured and operated so that reasonable assurance is provided of:
 - (1) the ability to carry on its business in an orderly and efficient manner;
 - (2) the safeguarding of its and its clients' assets;
 - (3) the maintenance of proper records and the reliability of financial, operational, and regulatory reports; and
 - (4) the compliance with all applicable acts and regulatory requirements.

C. International Standards

COSO

10. Under the 2013 Framework, the five components of internal control remained largely the same, namely: **control environment, risk assessment, control activities, information and communication, and monitoring activities**, which is now segmented into seventeen principles.

Basel Committee on Banking Supervision ("BCBS")

11. The BCBS issued the *Framework for Internal Control Systems in Banking Organizations* in September 1998 (the "Basel Internal Control Guidance"). The Basel Internal Control Guidance was issued as part of BCBS efforts to address bank supervisory issues and enhance banking supervision through guidance that encourages sound risk management practices. BCBS established that a system of effective internal controls is a critical component of bank management and a foundation for the safe and sound operation of banking organisations. The guidance sets out that the internal controls consists of five interrelated elements: (1) management oversight and control culture; (2) risk recognition and assessment; (3) control activities and segregation of duties; (4) information and communication; and, (5) monitoring activities and correcting deficiencies.
12. With regards to the Basel Internal Control Guidance, it is evident that the internal control components are still relevant today and are in alignment with the COSO's 2013 Framework.

International Organization of Securities Commission ("IOSCO")

13. IOSCO is the global standard setter for securities markets regulation. IOSCO establishes that appropriate risk management frameworks and internal controls systems are crucial for a firm's control environment. Additionally, it outlines that to achieve the institution's objectives, the most effective use of corporate resources and assets must be utilised, ultimately protecting investors in securities markets and aid in the integrity of those markets. In 1998, IOSCO issued *Risk Management and*

¹ Entities registered under the Securities Investment Business Act (as amended)

Control Guidance for Securities Firms and their Supervisors. This guidance is largely aligned with COSO's 2013 Framework and other best practice in internal controls.

International Association of Insurance Supervisors ("IAIS")

14. IAIS is the international standard-setting body responsible for developing and assisting in the implementation of principles, standards, and other supporting material for the supervision of the insurance sector. The IAIS mission is to promote effective and globally consistent supervision of the insurance industry to develop and maintain fair, safe, and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability. The Insurance Core Principles ("ICPs") provide a globally accepted framework for the supervision of the insurance sector.
15. The guidance under ICP 8 sets out the requirements to be implemented for the insurance sector, which at a high level, encompasses the five components and seventeen principles outlined in the COSO's 2013 Framework.
16. Based on the review of the international standards outlined above, the Authority considers that the international standards are well aligned with the COSO's 2013 Framework. As appropriate, the proposed measure considers the requirements established by each international body and would therefore reflect adherence to international best practice on internal controls.

D. Purpose of Proposed Measure and Consistency with the Authority's Functions

17. Section 6(1) of the MAA outlines the principal responsibilities of the Authority, which includes its regulatory functions, inter alia, *"to regulate and supervise financial services business carried on in or from within the Islands"*.
18. Section 6(3) of the MAA provides that in performing its regulatory functions, the Authority shall, inter alia:
 - (a) *endeavour to promote and enhance market confidence, consumer protection and the reputation of the Islands as a financial centre;*
 - (b) *endeavour to reduce the possibility of financial services business or relevant financial business being used for the purpose of money laundering or other crime;*
19. The purpose of the proposed measure is to ensure that:
 - (1) the current Rule and the four SOGs on Internal Controls are consolidated into one Rule and Statement of Guidance with expanded applicability to all entities supervised by the Authority; and
 - (2) the measure is updated to incorporate best practice on internal controls, including, as applicable, changes introduced in COSO's 2013 Framework.

E. Jurisdictional Comparison

20. The Authority conducted a jurisdictional comparison to establish characteristics of internal control measures in selected jurisdictions. This comparison sought to highlight, among other things: whether measures issued contained the five components and the seventeen principles of effective internal control as promoted in COSO's 2013 Framework; the type of measure issued; and, whether the jurisdiction issued sector-specific rules and guidance. Table 2 below outlines the characteristics of the regulatory measures on internal controls in the selected jurisdictions.

Table 2: Characteristics of Internal Controls Measures in Selected Jurisdictions

Requirements	Jurisdictions							
	Bahamas	Bermuda	Canada	Hong Kong	Jersey	Singapore	United Kingdom	Cayman Islands (proposed)
<i>Type of Measure</i>	Guidance Note	Policy	Guideline	Guideline	Code of Practice	Guideline	Guidance	Rule and Statement of Guidance
<i>Latest publication</i>	March 2000	Ranging from 2012-2020	September 2018	April 2003	2021-2022	July 2014	September 2014	2022 ²
<i>Sector specific guidance</i>	Yes	Yes	No	Yes	Yes	No	No	Yes
<i>Measure covers the five components of Internal Controls</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>Measure covers the 17 internal control principles³</i>	Except 4 and 15	Yes	Except 4, 11 and 15	Except 15	Except 2,4 and 15	Yes	Yes	Yes

² The proposed measure under this consultation

³ Refer to <https://www.coso.org/Shared%20Documents/Framework-Executive-Summary.pdf> for the seventeen internal control principles and the five components of effective internal control.

21. The jurisdictional comparisons presented in Table 2 above highlighted that all measures issued across the selected jurisdictions included the five components necessary for effective internal controls as outlined within COSO's 2013 Framework. Additionally, most of the measures considered the seventeen principles recognised in the COSO's 2013 Framework and included sector specific guidance. The Authority believes that the proposed measure on Internal Controls is aligned with the extent in which corresponding measures have been adopted in the selected jurisdictions.

F. Cost and Benefit Analysis

22. Table 3 shows the significant costs and benefits associated with the issuance of the proposed measure.

Table 3: Cost Benefit Analysis of Implementing the Proposed Measure

	Costs	Benefits
CIMA	<p>The Authority will incur administrative costs related to the following:</p> <ol style="list-style-type: none"> 1. research and development of the measure, including costs relating to the consultation process and gazettment of the measure. This cost is expected to be one-off. 2. one-off costs relating to development of the framework for evaluating effectiveness of internal controls. 3. usual ongoing monitoring costs to ensure compliance with the measure. 4. training staff on the requirements of the measure. 	<p>The Authority stands to benefit from:</p> <ol style="list-style-type: none"> 1. closure of the regulatory gap where some sectors were not appropriately covered by regulatory measure on internal controls. 2. improvement internal control systems for regulated entities resulting in better regulatory reporting and compliance. 3. efficiencies in supervision resulting from improved internal controls of regulated entities. 4. improved clarity with respect to the Authority's expectations on internal controls, thereby facilitating enforcement actions in the event of noncompliance.
Cayman Islands	<p>Possible costs associated with:</p> <ol style="list-style-type: none"> 1. some entities opting to leave the jurisdiction rather than complying with the requirements of the measure. This is expected to be minimal as no significant new burden is being imposed by the measure since most regulated entities already have a system of internal controls in place. 	<p>The jurisdiction stands to benefit from:</p> <ol style="list-style-type: none"> 1. enhanced safeguard of the jurisdiction's reputation through minimization of risks associated with weak internal controls for regulated entities. Such risks include, among others: fraud, improper reporting, and breach of acts and/or regulations. 2. improved safety and soundness of regulated entities resulting from better systems of internal controls. 3. improved compliance with international guidance relating to best practices on internal controls.

	Costs	Benefits
Regulated Entities	<p>There will be costs associated with:</p> <ol style="list-style-type: none"> 1. establishment and implementation of internal controls to meet the requirements of the measure particularly for entities that were not subject to the rule. 2. assessment of effectiveness of internal controls. 3. ongoing staff training on the proposed measure. 	<p>The industry will benefit from:</p> <ol style="list-style-type: none"> 1. more clear guidance with respect to the Authority's expectations on internal controls. 2. improvement in the system of internal controls, thereby contributing to achievement of the organizations' objectives. 3. improvement in efficiency of operations resulting from improved internal controls.
Summary	<p>Consequent to the above, it is determined that the benefits of implementing the measure outweigh the costs associated with it. As such, issuance of the Rule and Statement of Guidance on Internal Controls for Regulated Entities should be pursued by the Authority.</p>	

G. Consultation Feedback and Comments

23. Before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations only. Feedback submitted by individuals, entities, or other bodies, unless acting on behalf of private sector associations, will not be accepted by the Authority. Representations from private sector associations must be submitted as a consolidated document, and a listing of the entities which provided feedback should be included. Private sector associations should ensure that conflicting positions are resolved prior to submission to the Authority. Where positions conflict within or across associations, the Authority will consider all available information in taking a decision, which will be at its sole discretion.
24. To ensure that all responses are given due consideration, it is important that private sector associations make clear reference to the sections of the measure being commented on, and that responses are unambiguous, clearly articulated and based on fact. The consultation process is not designed to address complaints or grievances. Feedback of this nature should be submitted through the established complaints process.
25. In cases where the feedback proposes to change a policy position of the Authority or substantially amend any requirement of the draft measure, information to support the position of the association must be provided. The table below provides an example of the Authority's expectation with regard to feedback for the proposed measure.

Reference	Example of a Helpful Comment	Examples of Comments needing more Support
Rule 4.2 ⁴	In Rule 4.2 the current text omits the fair value measurement of liabilities. Also, as defined it is not asymmetrical with the Market Price definition and	<ul style="list-style-type: none"> × This is not what is done in other jurisdictions. × I don't think we should do this.

⁴ This example is not reflective of the content of the proposed measure.

Reference	Example of a Helpful Comment	Examples of Comments needing more Support
	thus scenarios exist that fall into neither category. Suggested wording: <i>Hard-to-Value Securities means an asset or liability for which there is no Market Price which is required to be measured at fair value pursuant to 5.2</i>	× CIMA is not considering the position of the experts.

26. All feedback submitted by private sector associations will be given due consideration, nevertheless, the decision to adopt any feedback provided into a proposed measure will be at the sole discretion of the Authority.

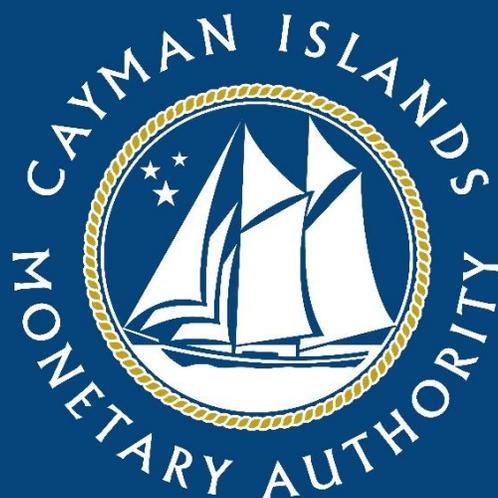
H. Notice of Representations

27. The Authority seeks consultation through written comments and representations from the private sector associations concerning the proposed *Rule and Statement of Guidance on Internal Controls for Regulated Entities*.
28. The Authority must receive representations by 1700hrs **on September 23 2022**. Representations received after this deadline may not be considered and will not form part of the collated written response provided to private sector associations.

29. Comments and representations must be addressed to:

The Managing Director
 Cayman Islands Monetary Authority
 P.O. Box 10052
 SIX, Cricket Square
 Grand Cayman KY1-1001
 Cayman Islands
 Tel: 345-949-7089
 Fax: 345-946-5611
 Email:
consultation@cima.ky
 and copied to [KennedyMutunga@cima.ky]

30. 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.



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