

**CAYMAN ISLANDS MONETARY AUTHORITY**  
**18-MONTH REPORT**  
**JANUARY 1, 2003 – JUNE 30, 2004**

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## MISSION STATEMENT

- To preserve the value and integrity of the Cayman Islands currency
- To regulate the financial services industry and to assist overseas regulators in a manner which meets internationally applied standards appropriate to the Cayman Islands and which enhances market confidence and the reputation of the Cayman Islands
- To foster sound, honest, competitive and innovative financial services and markets
- To act in the best economic interests of the Cayman Islands and in a fair, open, efficient and cost-effective manner

**Note:**

*The Board of Directors of the Monetary Authority adopted an updated mission statement in July 2004, which reads:*

*“As the primary financial services regulator our mission is to enhance the economic wealth and reputation of the Cayman Islands by fostering a thriving and growing, competitive, and internationally recognised financial services industry through appropriate responsive, cost-effective and efficient supervision and stable currency.”*

## CHAIRMAN'S STATEMENT

Despite the ever-changing landscape of financial markets globally, the financial industry in the Cayman Islands has shown resilience. Overall the economy of the Cayman Islands is expected to experience continued expansion with projections indicating an increase in economic growth from 2.0 % in 2003 to 2.8 % in 2004. This upward trend mirrored the performance of the global economy and was reflected in continued buoyant activity in the financial services industry and the local economy generally. All sectors showed signs of health with the captive insurance and mutual funds sectors demonstrating the most growth.

The Monetary Authority's transition to operational independence in March 2003 has significantly enhanced the ability of the Authority to meet international standards of supervision, accountability and transparency while giving the benefit of more clearly defined functions, duties, powers and obligations. In addition, the creation of an Executive Committee of the Board, and the establishment of a Management Committee comprised of heads of the divisions and which meet separately to deal with licence applications, revocations and enforcement actions have facilitated a more efficient licensing and supervisory process.

Much of the success of Cayman's financial industry can be attributed to the high standard of supervision the Monetary Authority exercises in overseeing the largest offshore financial centre in the world. This sentiment was echoed by the International Monetary Fund which found 'good evidence of a developed compliance culture' in its September 2003 assessment of the regulation and supervision of the financial services industry in the Cayman Islands. The Authority is certainly pleased that international standard-setting bodies like the IMF acknowledge the commitment of the Cayman Islands to continuously bolster the quality of its regulatory framework.

As a responsible regulator, the Monetary Authority regularly takes the initiative to take a closer look at its regulatory regime. To this end, the formation of working groups and task forces has resulted in major recommendations and amendments to enhance laws and regulations under which the financial services industry is supervised and the way in which the Monetary Authority carries out its supervisory functions.

As Chairman of the Board, it gives me much pleasure to welcome the newest Board members, Ms. Letitia Solomon; Mr. Don Seymour; Mr. James Kelleher, P.C., Q.C.; Sir Alan Traill, GBE, QSO, MA and Dr. Warren Coats. They join previously appointed members Deputy Chairman Mr. Timothy Ridley, OBE; Managing Director Mrs. Cindy Scotland; Mr. Linburgh Martin and Dr. Richard Rahn. This new Board of Directors, which is comprised of leading local and overseas individuals, is challenged to lead the Monetary Authority to fulfil its greatest potential. I am confident that, with the unwavering support of our skilled management team and employees, we will realise this goal.

## MANAGING DIRECTOR'S STATEMENT

The past eighteen months have been extremely challenging for the management and staff of the Monetary Authority. Each employee is to be commended for adapting to the many changes that occurred during the period, whilst remaining committed to ensuring the effective oversight of Cayman's financial services industry.

The status of the Cayman Islands as a respected jurisdiction is enhanced, in part, by the Monetary Authority's involvement with international regulatory organisations. The Monetary Authority is a leading participant of, to name a few, The Offshore Group of Banking Supervisors, The Caribbean Group of Banking Supervisors, The International Association of Fraud Agencies, The Offshore Group of Collective Investment Scheme Supervisors, and The Offshore Group of Insurance Supervisors, for which the Monetary Authority's Head of Insurance Supervision serves as Secretary. Membership of these bodies enables the Monetary Authority to keep abreast of international regulatory developments, and ensures the Cayman Islands a voice in the development of new standards.

As part of its goal to strengthen all areas of the Monetary Authority, a proactive and rigorous professional development programme is employed in an effort to intensify employees' awareness of best practices and trends within their respective areas. As a result, during the reporting period, countless members of staff from all levels achieved various certifications and attended a variety of training courses. Many of these were offered through the Federal Reserve Bank, the Caribbean Regional Technical Assistance Centre (CARTAC), The Toronto Centre and the Caribbean Financial Action Task Force (CFATF).

Over the past few years, the Monetary Authority has experienced significant growth in staff numbers in order to accommodate the increased volume of business activity. In addition, the many changes taking place throughout the organisation has resulted in fluctuations in staff numbers. Nevertheless, the Monetary Authority has retained high-quality employees.

The Monetary Authority has a proven track record for effectively and efficiently responding to change, as reflected throughout this report. Through the concerted efforts of our division heads and their teams, the mission of the Monetary Authority will be achieved, and ultimately result in the continued success of Cayman's financial industry.

## **CAYMAN ISLANDS MONETARY AUTHORITY**

The Cayman Islands Government enacted legislation granting full operational independence to the Cayman Islands Monetary Authority effective March 10, 2003.

Operational independence under the Monetary Authority Law (2003 Revision) (the “Law”), gives the Monetary Authority more clearly defined functions, duties, powers and obligations and enables the Monetary Authority to better meet relevant international standards of accountability and transparency. The key change resulting from operational independence is that powers previously vested in the Cabinet to issue and revoke licences and to exercise enforcement powers now vest in the Monetary Authority, through its Board of Directors.

The Cayman Islands Government wholly owns the Monetary Authority. Cabinet appoints the Board, which is comprised of up to 10 members, for fixed terms of three years, and members are eligible for reappointment. In order to demonstrate independent decision-making by the Monetary Authority, no member of the Cabinet or the Legislative Assembly may sit on the Monetary Authority’s Board. Key board members are the Chairman, Deputy Chairman and Managing Director, who are all appointed by Cabinet following consultation with the Board. A director’s appointment can only be terminated in circumstances set out in the Law including where Cabinet considers it in the public’s best interest, if the director becomes bankrupt, is convicted of a criminal offence, fails to disclose conflicts of interest, or is guilty of serious misconduct in relation to his duties.

Under the Law, the four principal functions of the Monetary Authority are:

1. monetary function - the issue and redemption of the Cayman currency and notes and the management of currency reserves;
2. regulatory function - 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.
3. co-operative function - the provision of assistance to overseas regulatory authorities, including the execution of memoranda of understanding to assist with consolidated supervision; and
4. advisory function - advise Government on monetary, regulatory and co-operative matters.

The primary obligations of the Monetary Authority in carrying out its functions are:

1. to be efficient and act in the best economic interests of the Cayman Islands;
2. to promote and maintain a sound financial system and reduce the use of financial services business for criminal purposes;
3. to promote and enhance market confidence, consumer protection and the reputation of the Cayman Islands as a financial centre;
4. to recognise international character of financial services/markets and the need to be competitive for consumers and suppliers while complying with appropriate and relevant international standards; and
5. to be transparent and fair

In fulfilling these obligations, the Monetary Authority is subject to appropriate oversight and accountability. Cabinet retains the power to give the Monetary Authority directions in the public interest and to issue regulations including setting licence fees. Additionally, officials of the

Monetary Authority can be called before the Legislative Assembly, and Cabinet can appoint an independent person to review its performance.

The Monetary Authority as a statutory authority under the Public Management and Finance Law is subject to an annual statutory audit, and the Legislative Assembly must approve its annual budget and funding. For this purpose it enters into annual operating and purchase agreements with the Government. The Monetary Authority obtains its funding by the Cayman Islands Government purchasing specified services, e.g. regulatory outputs. These outputs are related to the regulatory and currency functions of the Authority. The price of the output is based on the cost of providing it including necessary administrative overhead. The agreed outputs and their costs becomes the budget for the Monetary Authority and the level of its Government grant. Although the Authority earns investment income on the Currency Reserve Assets, this income is paid over to the government after satisfying all the reserve requirements at year-end. In addition, licensing and operating fees from the industry that are collected by the Monetary Authority belong to the Government. The Authority also enters into an Ownership agreement with the Government. The Ownership agreement identifies the Authority's strategic goals and objectives, which are used to evaluate the Authority's performance.

The Monetary Authority's accountability to the private sector has been formalised through a private sector consultation process. This consultation has to be conducted prior to issuing or amending rules or statements of principle or guidance regarding conduct of licensees and money laundering regulation. The consultation process requires the Monetary Authority to explain the purpose of the measure confirming that the measure is compatible with the Monetary Authority's functions and duties. As part of the consultation, a cost/benefit analysis must be provided and a minimum of 30 days for comment must be allowed. The Monetary Authority also gives a written response to representations, and forwards all representations including its response to Cabinet. Emergency exceptions are permitted. Final approval of rules and statements of guidance and principle (and amendments) rests with Cabinet. The Monetary Authority is also required to make recommendations to the Cabinet regarding its functions and laws, regulations or directions, and if so directed by the Financial Secretary to consult with the industry on these recommendations.

One of the primary functions of the Monetary Authority is to cooperate with overseas regulatory authorities to enable them to carry out their regulatory functions including the conduct of civil and administrative investigations and proceedings to enforce laws, regulations and rules administered by requesting overseas regulatory authorities.

Since 2000 the Monetary Authority has processed more than 400 requests for assistance and provided assistance in approximately ninety-eight percent of these cases. In the few instances in which requests for assistance were not granted, the requesting parties were either unable or unwilling to provide appropriate undertakings required under the Law with respect to the use and protection of confidentiality of the information provided. The Monetary Authority is able to provide information on its files as well as information obtained pursuant to the exercise of its compulsory powers under the Law, including client information where appropriate and necessary to the carrying out of the requesting overseas regulatory authority's functions.

The Monetary Authority is also authorized to enter into Memoranda of Understanding (MOU) in the exercise of its cooperative function. As at June 30, 2004 the Authority has entered into MOUs with three overseas regulators and is actively engaged in discussion with several others in reaching agreement on MOUs or other cooperation agreements.

As a result of operational independence, changes have been made with respect to the Monetary Authority's management structure and its operating procedures. The Board may delegate any of its duties and powers to a committee of the Board. It has appointed an Executive Committee of local directors to make decisions on enforcement actions and applications for securities investment business licences. Additionally, the Board may delegate any of its duties and powers to other committees or the Management Committee, except a duty or power expressly imposed or conferred on the Board by the Law. The Management Committee, which consists of the management of the Monetary Authority, has been delegated authority for licensing and supervisory decisions and related matters.

To promote operational effectiveness, five sub-committees of the Board have been established: Audit and Finance; Policy, Strategy and Relations; Structure and Governance; Legislative and Legal; and Human Resources.

The Audit and Finance committee deals the Monetary Authority's financial position and results of operations. It reviews the financial reporting process, the system of internal control, the audit process and any other financial and audit matters referred to it by either the Board or Management

The Policy, Strategy and Relations committee develops together with the Structure and Governance Committee and management the mission and goals of the Monetary Authority and the accompanying strategies, actions and procedures. In conjunction with management it develops new rules, statements of guidance and principle and policies and submits recommendations to the Board.

The Structure and Governance committee advises the Board on issues pertaining to the organizational structure and the direction and control of the Monetary Authority. The Legislative and Legal Committee reviews and reports on any legal, legislative and regulatory matters referred to it either by the Board or management. Additionally, the Legislative and Legal Committee keeps under review with management local and international legal, legislative and regulatory developments relevant to the Monetary Authority.

The Human Resources committee advises the Board on staff terms and conditions of employment including remuneration and benefits, the staff handbook, the overall manpower requirements of the Authority and issues pertaining specifically to its executives.

Ensuring the fitness and propriety of all regulated persons and entities is critical to the Monetary Authority's supervisory approach. In achieving this, status reports are prepared for the Board monthly. These reports contain a listing of all licensing decisions taken, and all other recommendations provided to Cabinet for consideration in relation to regulation and currency.

As part of its statutory obligation of transparency and fairness, the Monetary Authority released its interim Regulatory Handbook in September 2003. This publication sets out the policies and procedures to be followed by the Monetary Authority, its committees, and officers in performing the regulatory and co-operative functions of the Monetary Authority. It includes details of the consultation process with the private sector associations and approval by Cabinet, and is regularly updated and expanded.

Post-independence, supervision continues to consist of two primary components namely, off-site and on-site supervision. Off-site supervision is continuous, involving the analysis of quarterly prudential returns and annual audited statements, supplemented with prudential meetings. On-



site supervision takes the form of prudential meetings, limited scope visits, and supervisory visits both in the Cayman Islands and overseas.

The objectives of the inspection process are to understand the licensee's business activities and operating environment, to detect problems of compliance with the relevant laws and/or regulations; and to gather information on matters identified as requiring policy considerations.

Operational independence for the Monetary Authority will strengthen financial services regulation and supervision in the Cayman Islands and is a critical component in achieving the Monetary Authority's goal to enhance the wealth and reputation of the Cayman Islands by fostering a thriving, competitive and respected financial services industry through responsive and efficient supervision.

## **DIRECTORS AS AT JUNE 30, 2004**

### **Mr. Michael Austin, M.B.E., F.C.A. (Chairman)**

Mr. Austin has been a member of the Board since the Monetary Authority's inception on January 1, 1997. He is a resident of the Cayman Islands, and is a Chartered Accountant. Mr. Austin was admitted as an Associate of the Institute of Chartered Accountants in England and Wales in 1964, and as a Fellow in 1969. He is also an Associate Member of The Chartered Institute of Taxation, a Member of the Society of Trust and Estate Practitioners, and a Notary Public of the Cayman Islands. Mr. Austin served as the managing partner of the Cayman Islands office of KPMG for 23 years. Since retiring in July, 1992 Mr. Austin has been a consultant and currently serves as non-executive director on several company boards.

### **Mr. Timothy Ridley, O.B.E. (Deputy Chairman)**

Mr. Ridley is a former senior partner of the largest law firm in the Cayman Islands. He specialized in global Cayman Islands legal practice with particular emphasis on institutional banking, capital markets, corporate/commercial finance, insurance, mutual funds and corporate and high net worth private client trust matters. From early 1995 until the end of 1999, he was principally based in Hong Kong heading up the Asia practice of the firm. Mr. Ridley is a graduate of Cambridge University (B.A.) and Harvard Law School (LL.M.) and qualified as a solicitor in England. He has practised as a Cayman Islands attorney-at-law and notary public for 30 years. He has written and spoken widely on Cayman Islands' legal matters. He is a member of The International Bar Association, The International Union of Advocates and The Society of Trust and Estate Practitioners, and a member of the board of editorial advisors of (a) Trusts & Trustees and (b) The Journal of International Trust and Corporate Planning. He was previously a co-editor of The Harvard International Law Journal, a member of the editorial board of The Chase Journal, an editorial advisor to Asian Lawyer and country correspondent for Tax Notes International.

Mr. Ridley has served on various consultative committees advising the Cayman Islands' Government on matters relating to the financial and local industries. He is currently a member of the National Advisory Council, which is mandated to advise the Government on fiscal, economic, cultural and legal matters, and the Private Sector Consultative Committee which consults with the Department of Finance and Development on issues relating to the financial industry. In July 2002, he was appointed to the Boards of the Cayman Islands Monetary Authority and The Health Services Authority.

**Mrs. Cindy Scotland (Managing Director)**

Prior to being appointed as Managing Director, Mrs. Scotland spent over 12 years in the public sector. She spent the first five years of her career with the Cayman Islands Currency Board, three years as Manager of the Board. Mrs. Scotland assumed the role of Head of Currency Operations upon the establishment of the Monetary Authority in January 1997 and was subsequently promoted to General Manager in July 1997. During her tenure as General Manager, Mrs. Scotland worked closely with the Managing Director in providing advice and support, whilst being actively involved in the regulatory aspects and day-to-day decisions of the Monetary Authority. Mrs. Scotland currently chairs the Cayman Islands Guidance Notes Committee and is a member of the Private Sector Consultative Committee, which consults with the Department of Finance and Development on issues relating to the financial industry. She also sits on the Anti-Money Laundering Steering Committee and the Stock Exchange Authority. Mrs. Scotland received a BA in Economics from Macalester College and is a Notary Public of the Cayman Islands. She was named the 2004 recipient of the Young Caymanian Leadership Award, which recognises well-accomplished young Caymanians with a spirit of volunteerism.

**Mr. Linburgh Martin**

Mr. Martin is the Managing Director of Close Brothers (Cayman) Ltd. He is a member of the Institute of Chartered Accountants in England & Wales and a member of the Society of Trust and Estate Practitioners. He is a council member of the Cayman Islands Society of Professional Accountants and a trustee of the Public Service Pension Board. Mr. Martin was appointed a member of the National Advisory Council for the year 2002. The National Advisory Council provides policy advice to the Governor in Council on fiscal, economic, socio-cultural and legal matters.

Upon graduating from the University of Kent at Canterbury, Linburgh Martin joined Ernst & Young in London. Having completed his training and qualifying as a Chartered Accountant he returned to the Cayman Islands practice of Ernst & Young in the audit division. During his time in the audit division in London and the Cayman Islands he managed a portfolio of clients which included insurance companies, banks, hedge funds and large manufacturing concerns. In 1994 he moved to Chartered Trust, which was acquired by Close Brothers Group plc (Close Brothers) in April 2001. Close Brothers is the largest quoted independent merchant bank in the United Kingdom.

**Dr. Richard W. Rahn**

Dr. Rahn is a senior fellow of the Discovery Institute, and an adjunct scholar at the Cato Institute, and an economic columnist. In the 1980s, Dr. Rahn served as Vice President and Chief Economist of the Chamber of Commerce of the United States. Previously, he was the Executive Director of the American Council for Capital Formation. He has advised senior government officials on tax and monetary policy matters in a number of countries, including Russia, Estonia, and Hungary. He served as the U.S. co-chairman of the Bulgarian Economic Growth and Transition Project in 1990. In 1982, President Reagan appointed Dr. Rahn as a member of the Quadrennial Social Security Advisory Council. During the 1988 Presidential campaign, he served as an economic advisor to President G.H.W. Bush. Dr. Rahn is the founder of the Novecon companies, which include Sterling Semiconductor Inc. (now owned by Dow Corning), and Novecon Financial Ltd. which he still chairs. Professor Rahn taught at several universities including the Polytechnic University of New York, where he served as head of the graduate Department of Management. Dr. Rahn has written hundreds of articles for newspapers and magazines such as the Wall Street Journal, The Washington Times, USA Today, American Spectator, National Review and The Weekly Standard; has contributed to numerous books and professional journals, and served as editor-in-chief of the Journal of Economic Growth. He is the author of the book *The End of Money and the Struggle for Financial Privacy*, and has

testified before the U.S. Congress on economic issues more than seventy-five times. Dr. Rahn earned a Ph.D. in business economics from Columbia University (1972). He was awarded an honorary Doctor of Laws by Pepperdine University (1993).

**Mr. Don M. Seymour**

Mr. Seymour is the Managing Director of dms Management Ltd., a company management firm, licensed and regulated under the laws of the Cayman Islands. Formerly, he was the Head of the Investment Services Division of the Monetary Authority where he directed the authorization, supervision, and enforcement of regulated mutual funds and mutual fund administrators under the Mutual Funds Law, and the supervision of company managers under the Companies Management Law. Prior to joining the Monetary Authority, he was a Manager - Audit and Business Advisory Services, Price Waterhouse, Grand Cayman, and a Senior Accountant, Investment Management Services Group, Price Waterhouse LLP, New York, where he managed and coordinated global, multi-disciplinary teams to deliver professional audit and business advisory services to major investment management clients, including the largest offshore investment companies in the world. In November 2001, he was appointed by the Cayman Islands Government to the Board of Directors of Cayman Airways Limited, the national airline of the Cayman Islands, as the Director responsible for reorganizing the financial strategy of the airline and improving its financial performance. He has contributed to many articles on the offshore financial industry in financial magazines and as a speaker at various conferences. He is a Notary Public and a previous member of the Trade & Business Licensing Board of the Cayman Islands. In 1991, he obtained a BBA degree in Accounting from the University of Texas at Austin and qualified as a Certified Public Accountant in the State of Illinois.

**Miss Letitia Solomon**

Miss Solomon is Senior Assistant Secretary in the Office of the Financial Secretary, having been promoted to this position in 1996. She is responsible for providing policy advice to the Financial Secretary on a wide range of financial subjects, with special emphasis pertaining to the financial services industry. She is also the Government's liaison officer for the Monetary Authority and Secretary to Government's Private Sector Consultative Committee. Miss Solomon began her career in 1987 as a banking analyst with the Banking Supervision Department (currently the Monetary Authority and has nine years experience in banking supervision including a one-year secondment to the Bank of England, Banking Supervision Department (1993-1994). Miss Solomon obtained a Bachelor of Science Degree in Finance, from the University of South Florida in 1987 and was awarded a Master of Business Administration, in the specialty area of Strategic Management and Finance, from the University of Edinburgh in Scotland in 2001.

**Sir Alan Traill, GBE, QSO.**

Sir Alan has a wealth of experience in the International Insurance industry commencing in 1956 when he was employed by Lloyd's Broker, Morice Tozer & Beck, and subsequently became a Director in 1960. He was made responsible for reinsurance development particularly in Italy and Spain. In 1969 was appointed Broker to Insurance Corporation of Singapore. In 1970, he helped form a Reinsurance Company at the request of the Mauritius Government to trade in World-Wide property reinsurance with a view to creating invisible earnings. He became a Member of Lloyd's in 1964 (resigned 1986). In 1973 Sir Alan co-founded his own Broking Company, Traill Attenborough Ltd, and was its Chairman 1978-86. In 1978 he was Chairman of the Reinsurance Committee of B.I.B.A. As such, the Regulatory Authorities of both Bermuda & Hong Kong consulted him. In 2000 he created his own Insurance Consultancy and Arbitration practice and is trained in Alternative Dispute Resolution. He is a Committee Member of ARIAS. In 2002 he acted as an Expert Witness in that year's longest civil trial involving an alleged conspiracy

between a Cover holder and a Lloyd's Broker. Sir Alan was educated at Charterhouse and has a MA (Law) from Cambridge University. In 1970 he was elected onto the City of London Council; in 1975 became an Alderman, and served the office of Lord Mayor of London in 1984.

**Senator James F. Kelleher, P.C., Q.C.**

A former Member of Parliament and former federal minister, Senator Kelleher has served as counsel with Gowlings Toronto since 1991 in the area of corporate and commercial law, focusing on international trade. Senator Kelleher was elected to the House of Commons in 1984. That same year he was sworn in as Minister for International Trade, where he prepared, introduced and launched negotiations for the Canada-United States Free Trade Agreement (FTA). Senator Kelleher also served as Minister responsible for Canada's Trade Policy and Trade Development. Among other international trade initiatives, he was deeply involved preparing for the Uruguay Round (GATT) of negotiations, now completed. In 1986, Senator Kelleher was appointed Solicitor General of Canada with responsibility for the RCMP, CSIS, the Correctional Services of Canada, and the National Parole Board. Over 1989 and 1990 Senator Kelleher served on the Binational Panels resolving disputes relating to the interpretation and application of the FTA. Appointed to the Senate of Canada in 1990, Senator Kelleher serves as a member of the Banking Trade & Commerce Committee. He also serves as Vice-Chair of the Canada-China Business Council. Senator Kelleher currently serves as Chairman of the Board of IntesaBci Canada. Senator Kelleher was called to the Ontario Bar after completing his law studies at Osgoode Hall Law School. In 1968, he was appointed Queen's Counsel Ontario and in 1988, Queen's Counsel Canada.

**Dr. Warren Coats**

Dr. Coats is an economist with a BA from the University of California, Berkeley and a PhD from the University of Chicago. He retired from the International Monetary Fund in 2003 after 26 years of service. He also worked for the Board of Governors of the Federal Reserve System and for the World Bank as part of its World Development Report team (on the Financial System). Dr. Coats has taught at the University of Virginia, the University of Hawaii, and George Mason University.

Dr. Coats has published over thirty articles in economics journals on money and banking topics. He is also the author of one book and editor or coeditor of three books on money and banking topics. While at the IMF he lead technical assistance teams advising governments on: emergency and longer run measures for rebuilding money and banking systems in post crisis countries (Afghanistan, Bosnia and Herzegovina, Iraq, Kosovo, Yugoslavia); the development of new central banks including the introduction of new currencies (Croatia, Kazakhstan, Kyrgyzstan, Moldova, West Bank and Gaza Strip); the management of banking crisis (Bulgaria, Croatia, Moldova, and Turkey); and assessing financial sector stability (Bangladesh, Egypt, Israel, and Slovak Republic). Dr. Coats also assisted with the establishment of two currency boards (the Central Bank of Bosnia and Herzegovina, and Bulgaria National Bank), and lead technical assistance on inflation targeting at the Czech National Bank, National Bank of Slovakia, and the Central Bank of Turkey). Presently he lives in Arlington, Virginia and is working on the rehabilitation of the money and banking systems of Iraq and Afghanistan.

## **SENIOR OFFICIALS AS AT JUNE 30, 2004**

Stanley Legiersky	Financial Controller
Shan Whittaker	Deputy Head Currency Operations
Anna McLean	Head of Banking
Reina Ramos	Deputy Head of Banking
Mary Lou Gallegos	Head of Insurance
Morag Nicol	Deputy Head of Insurance
Gary Linford	Head of Investments and Securities
Patrick Bodden	Head of Fiduciary Services
Mitchell Scott	Head of Policy and Development
Robert J. Berry	Head of Compliance
Langston Sibblies	General Counsel
Simone March-Tomkins	Legal Counsel
Wendy Straker	Legal Counsel

## WHY THE CAYMAN ISLANDS?

The Cayman Islands has evolved into a thriving international financial centre. This journey began more than 30 years ago with the passing of a Banks and Trust Company Law in 1966. Today Cayman has the largest offshore banking centre in terms of total liabilities, remains the second largest market for captive insurance business on the basis of the total number of captives licensed, as well as being the preferred jurisdiction for more than fifty percent of the world's hedge funds. The Islands' full range of services extends to trusts, company management, securities business, structured financing, vessel registration, and listing on the stock exchange.

The jurisdiction's successful development into a leading centre for offshore finance has been achieved through providing the services, infrastructure and operational flexibility that the international investor demands within a framework of clear and enforced legal and ethical principles. As a British Overseas Territory, the Cayman Islands legal system is based on English common law. A tripartite group consisting of Government, the regulators, and a private sector carefully craft the balance between sound regulation and flexibility. Cayman's financial services industry operates within a regulatory environment that encompasses modern and evolving legislation, rigorous law enforcement, and international cooperation involving bi- and multi-lateral agreements allowing for the provision of international legal assistance. As a result, clear and fair legislation with appropriate cost-effective regulation and supervision can be efficiently developed to meet the changing needs of the global financial industry. Additionally, the political stability of the Cayman Islands and successful economy attract clients seeking to hedge political and economic risk from volatility and uncertainty.

Tax planning and asset protection are key features of the jurisdiction. Just about any type of income earning asset can be booked with a Cayman Islands bank and with immediate tax and/or asset protection advantages. As there is no direct taxation or exchange controls in the Cayman Islands income earning assets, such as fixed term deposits, listed stocks and securities, real estate income and commissions, inter alia can be held by a Cayman Islands corporation thus avoiding heavy taxation in other territories. Such benefits are likely to be more limited in jurisdictions, such as the U.S., where a tax liability may occur on the taxpayer's worldwide income.

Financial institutions base their activities in the Cayman Islands to capitalise on the pool of professional services offered, including the services of lawyers, chartered accountants, corporate managers and other highly skilled service providers. The existence of modern infrastructure, including state of the art telecommunications facilities and reliable utilities are also key contributors to Cayman's attraction as an offshore financial centre. Ease of access is a major advantage. There are direct flights to Cayman from the major financial centres of London, and New York, as well as Toronto, Atlanta, Chicago, Houston, Boston, Miami and the Bahamas, among others.

The Cayman Islands share the same time zone with New York (EST), which is convenient for conducting business. The EST time zone is equivalent to GMT minus 5 hours, which facilitates business with Europe during morning hours. The perennial sunny weather, world-class beaches, and the safety of the islands add value to Cayman as an attractive jurisdiction in which to conduct business.

Institutions and clients alike can be assured that conducting business in the Cayman Islands will afford them the best opportunity to maximize the potential of their assets conveniently with the added value of unparalleled professionalism, efficient regulation and confidentiality. In general,

Cayman is the premier choice for clients seeking a high level of sophistication and flexibility to maximize their return on investment in a highly reputable offshore jurisdiction.



## **PRIMARY DEVELOPMENTS**

### **IMF Assessment**

During the final quarter of 2003, the Monetary Authority participated in a voluntary assessment by the International Monetary Fund (IMF) of the supervision and regulation of financial services industry in the Cayman Islands. The IMF's preliminary report stated that "the implementation of financial regulation and supervision complies broadly with standards in all areas assessed," and found "good evidence of a developed compliance culture" regarding the supervision and regulation of financial services in the Islands.

The IMF eight-member mission team assessed supervision in the banking, insurance and securities sectors. The team also assessed the effectiveness of the regime for anti-money laundering and combating the financing of terrorism.

Cayman's approach to the banking industry supervision was found to be compliant or largely compliant in all 30 core principles assessed by the IMF.

A review of the securities and insurance industries revealed a strong professional infrastructure working closely with the Government for the furtherance of the good reputation and financial well being of the Islands as an international financial centre.

The IMF found that a sound supervisory programme "have developed an intense awareness of the measures to combat money laundering and the financing of terrorism." The report stated that Cayman's legal framework has undergone major revisions and improvements in the last four years and has put into place a comprehensive framework that in some respects exceed international standards.

Prior to the IMF assessment, the Monetary Authority had conducted a comprehensive self-assessment that largely mirrored the scope of the IMF review, and was thus aware of the likely primary areas of concern to be raised by the IMF.

The final report is expected in the first quarter of 2005. The Monetary Authority is already focusing on the key issues arising from the report in order to further strengthen and enhance the jurisdiction's high standard of supervision. This will lead to future consultation with the Government and private sector on new legislation and regulations.

### **Task Force Reviews**

Four strategic plan task forces, each under the chairmanship of a Board member, are assisting in further determining the Monetary Authority's future. The task forces are reviewing all aspects of regulation in relation to banking, insurance, investments and securities, and fiduciary services, and are undertaking their tasks in two stages:

- Stage 1 – a review of the regulations and legislation to ensure that such regulation meets the appropriate and relevant international standards.
- Stage 2 – a review of the organisation, staffing and procedures within each regulatory division to ensure that it is sufficient and appropriate to accomplish the defined tasks.

The work of the task forces is ongoing and Stages 1 and 2 are likely to be substantially completed in late 2004.

### **Mutual Funds Regulation**

As part of its obligation to review its regulatory laws on a periodic basis, the Monetary Authority established a Mutual Funds Working Group. The Group, comprised of private sector association representatives and senior Monetary Authority staff, commenced its work in November 2003 with a view to recommending legislative changes to the Mutual Funds Law (2003 Revision). The Group produced 25 such recommendations, 15 of which will require legislative amendments. Subject to Cabinet approval, these amendments are expected to clarify and enhance the framework for mutual fund business.

### **European Union Savings Tax Directive**

The Monetary Authority has not been directly involved in the dialogue between the Cayman Islands Government and the United Kingdom regarding the European Union Savings Directive. Nevertheless, it has been closely following the developments, as implementation of the Directive will impact the financial services industry in the Cayman Islands.

The Government has advised that, following extensive consultation with its financial services industry, the Cayman Islands has agreed to implement with the Member States of the European Union exchange of information measures consistent with the EU Savings Directive (2003/48/EC) with effect from 1 July 2005. The agreement is conditional on all EU member states, all named third countries (Switzerland, San Marino, Monaco, Andorra and Liechtenstein) and associated and dependent territories of EU member states (the Channel Islands, the Isle of Man and the dependent or associated territories in the Caribbean) implementing the Directive.

The scope of these exchanges of information measures is currently very restricted. The Directive will impose reporting obligations on “paying agents” within the Cayman Islands who make or hold payments of “savings income” for individuals who are tax residents of EU Member States. The obligation will require that a “paying agent” provide information for EU tax authorities on the amount of such payments of “savings income” together with details of the recipients. Persons, corporate structures, other investment vehicles and institutions that do not fall within the definitions will be unaffected.

By agreeing to exchange of information under level playing field conditions, the Cayman Islands are demonstrating a continuing commitment to high standards of transparency in cross-border financial transactions. This position is consistent with the quality of the financial services business that the Cayman Islands wish to continue to attract.

## SECTORS OVERVIEW

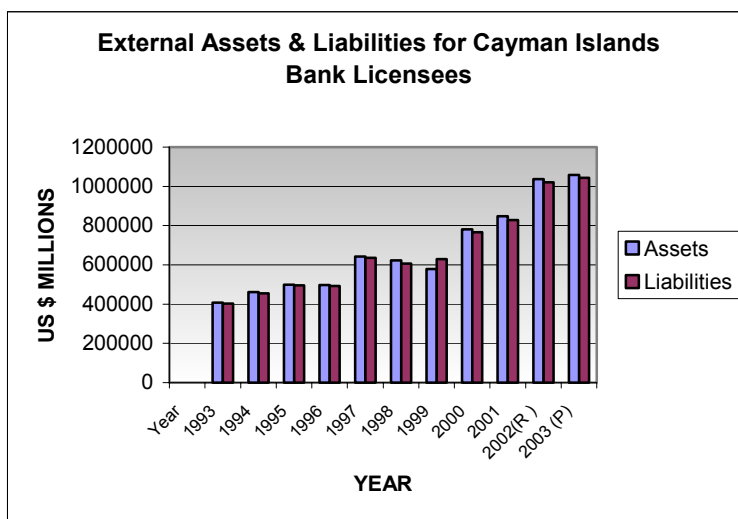
### SUPERVISORY DIVISIONS

#### BANKING SUPERVISION

The Banking Supervision Division (the “Banking Division”) is responsible for supervising and regulating the activities of licensed banks and trust companies in accordance with the Banks and Trust Companies Law (2003 Revision). The administration of the Money Services Law (2003 Revision) also falls to the remit of the Banking Division. Under this law, money services business is defined as the business of providing as a principal business any or all of the following services: money transmission; cheque cashing; currency exchange; and the issuance, sale or redemption of money orders or travellers cheques.

#### Industry Trends

The Cayman Islands has continued to hold its prominent position as the fifth largest banking centre and the largest offshore banking centre in the global financial market in terms of total liabilities. This was evident by the size of the banking sector and the number of leading international banks that maintain Cayman Islands operations. As at 30<sup>th</sup> June 2004 the jurisdiction hosted branches or subsidiaries of 45 of the world’s top 50 banks in terms of total assets. At the same time, the jurisdiction continued to see growth in the volume of financial activity booked through bank licensees. The chart below shows the continued growth in the external assets and liabilities of all Cayman Islands bank licensees.



Total international assets booked through banks in the Cayman Islands at the end of June 2004 stood at US\$1,144.4 billion as compared to US\$1,019.8 billion in June 2003. Liabilities rose to US\$ 1,109.1 billion, up from US\$981.5 billion as at June 2003<sup>1</sup>.

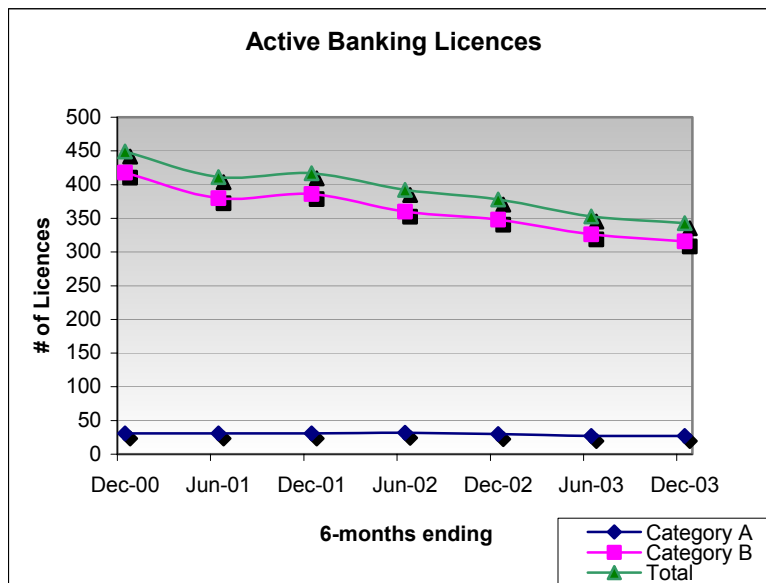
Generally, the banking sector has remained well capitalised with locally incorporated banks maintaining capital adequacy ratios in excess of 12% and quality performing assets.

The industry as a whole has been relatively resilient in a very challenging market. The domestic market continued to be serviced by six retail banks, three of which are subsidiaries of international banking groups, with one international banking group operating through a branch. As at 31<sup>st</sup>

<sup>1</sup>BIS Quarterly Review, June 2004

December 2003, the aggregate assets attributable to the domestic retail operations of the six institutions demonstrated notable growth. Aggregate assets were US\$ 8.5 billion, with loans totalling US\$ 3.193 billion and deposits of US\$ 7.7 billion, compared to December 2002, when aggregate assets were US\$ 6.4 billion, the aggregate loans issued were US\$ 2.2 billion and the aggregate deposits held were US\$5.8 billion.

Globally the number of financial institutions has continued to consolidate, as institutions seek to achieve synergies through mergers, realignment and restructuring. This trend, which has impacted on the number of institutions active in international centres around the world, is also evident in the decrease in the number of bank licensees in the Cayman Islands. As at the 30<sup>th</sup> June 2004 there were 332 banks licensed in the jurisdiction compared to June 2001 when there were over 400 bank licensees.



The jurisdiction continues to have two main categories of banking licences, namely categories “A” and “B”. The Category “A” Banking Licence allows financial service providers to operate both in the international and domestic market, whilst the Category “B” Banking Licence permits international banking business, and only limited domestic activity. The number of Category “A” licensees has remained relatively stable, with 23 institutions holding “A” licenses at 30<sup>th</sup> June 2004, compared to 27 at 30<sup>th</sup> June 2003. As the chart above shows there has been a steady decline in the number of Category “B” licensees over the past five years. While mergers and acquisitions have been a key factor in the decline, a number of institutions, which traditionally held multiple licenses, have also consolidated their activities into one entity.

For the 18-month period January 1<sup>st</sup>, 2003 through June 30<sup>th</sup>, 2004 the Monetary Authority issued 14 new banking licenses, compared to the previous period ending 30<sup>th</sup> June 2003, which saw 12 new licenses issued. During the period under review, there were 60 banking licences, which were surrendered. While the jurisdiction continues to attract banks from all over the world, it continues to be the choice jurisdiction for well established European and U.S. banking groups.

Currently, there are 194 branches and 96 subsidiaries of international banks licensed in the Cayman Islands.

Subsequent to 26<sup>th</sup> April 2003, a holder of a Category “B” Banking Licence which is not a subsidiary or branch of a bank licensed in a country or territory outside the Cayman Islands, shall not carry on business in the islands unless it has appropriate resources and books and records having regard to the nature and scale of the business. This pertains particularly to those banks for which the Authority is the home supervisor.

An objective of the licensing criteria is to ensure that only fit and proper persons own, control and manage banking institutions and that the business and affairs of these institutions are properly run with appropriate governance and internal controls, in compliance with the relevant regulatory laws and regulations.

### **Inspection Programme**

Off-site monitoring continues to play an integral role in the Monetary Authority’s risk based supervisory approach and complements the Banking Division’s on-site inspection programme. The objective of the inspection process is to assess a licensee’s compliance with applicable legislation, codes of practice and internationally accepted standards.

Off-site monitoring is compliance based and is also an important part of the supervisory process. In order to facilitate effective off-site monitoring, licensees are required to provide accurate and timely information through the completion of prudential returns detailing their balance sheet activity. The data generated from these returns allow the Banking Division to complete regular analytical reviews of institutions. As part of its offsite monitoring, the Monetary Authority conducts prudential meetings with licensees, discussing their strategies, performance, and changes in business plan and developments in the jurisdiction in which they originate. During the 18-month period under review the Banking Division conducted 184 prudential meetings.

In respect of on-site inspections, for the 18-month period ending 30<sup>th</sup> June 2004, the Division conducted 46 full scope on-site inspections and 20 limited scope inspections. While those institutions with offices in the Cayman Islands are inspected more frequently the Banking Division also conducts inspections overseas, having visited banks in Panama, Brazil and the United States during the period under review. The Banking Division also conducted joint inspections at banks on Grand Cayman with the Bermuda Monetary Authority and representatives of the Superintendent of Banks of Panama as part of those institutions consolidated supervisory efforts.

Through its inspection programme, the Banking Division has evidenced an improved compliance culture in most licenses, with the majority of financial institutions applying robust policies and procedures in line with international standards. In general, most banks have completed the retrofitting of the due diligence information for clients. Due to the volume of clients, a number of the retail banks continue to work on this project.

The Monetary Authority did not initiate any major supervisory action against any bank licensee for the period under review, compared to three controller appointments in the period ending 30<sup>th</sup> June 2003.

The Banking Division continued to monitor countries experiencing economic difficulties along with changes in the international regulatory arena, assessing the implications for Cayman licensed banks operating in developing markets.

## **Regulatory Developments**

A primary developmental issue facing the Banking Division is the preparation for and increasing the awareness of the implementation of the New Capital Accord – Basel II in G-10 countries at the end of 2006. Given the size and scope of the Cayman Islands' banking industry and the fact that a significant number of the banks licensed here are members of major internationally active banking groups, the Monetary Authority will have to give serious consideration to the implementation of Basel II, at least for such institutions.

The Banking Division along with representatives of the Policy and Development Division commenced discussions with local industry representatives and participated in a number of working groups and meetings to consider the implications of Basel II for the Cayman Islands and the region as a whole.

The operations and functions of the Banking Division were assessed in the third quarter of 2003 as part of the IMF's review of the jurisdiction's compliance with the Basel Core Principles and were generally found to be well in line with international standards. The Banking Division is also undergoing a review by a Task Force comprised of members of the Board of Directors. As a result of both reviews there will likely be some technical amendments to the Banks and Trust Companies Law (2003 Revision) and some refinement to the risk based supervisory approach currently in place in the Division. In addition, the banking industry will see an increased number of rules and statements of principle and guidance, documenting and formalising the policies and practices of the Banking Division to further enhance the transparency and effectiveness of its operations.

## **Staffing**

As at 30th June 2004 the Banking Division had a staff complement of 21. Compared to June 2003 there has been a net increase of two staff members within the Banking Division personnel. During the period, two staff members transferred to other divisions within the Authority, two resigned and six new appointments were made.

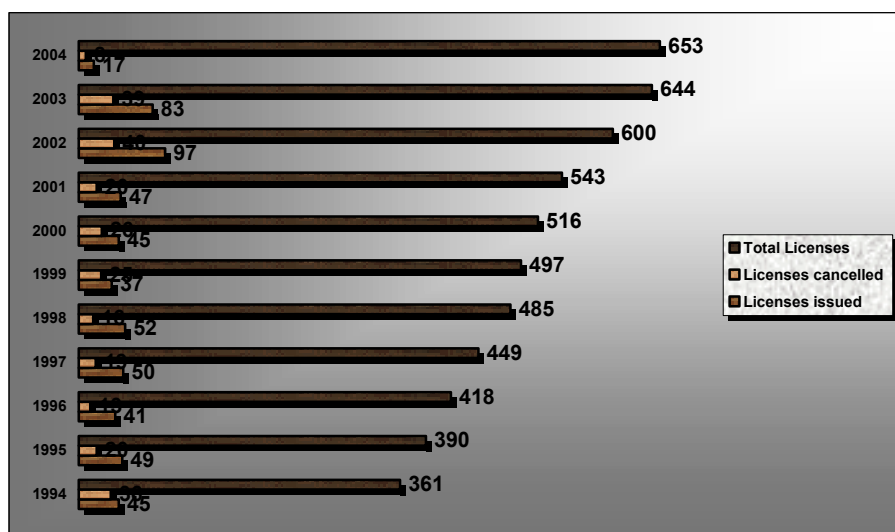
## INSURANCE SUPERVISION

The Insurance Supervision Division (the “Insurance Division”) is charged to regulate the insurance industry in accordance with the Insurance Law (2004 Revision) and is responsible for supervising all insurance companies, whether they operate domestically as Class “A” companies or as Class “B” (captive) insurance companies, which generally only accept overseas risks. The basis of the Insurance Division’s activities is formed by compliance with the core principles of the International Association of Insurance Supervisors (IAIS).

### Industry Trends

The Cayman Islands has successfully maintained its position as the second leading domicile worldwide for the formation of captive insurance companies. The hard commercial insurance market resulted in many lines of insurance being offered with significant rate increases, restrictive terms and higher deductibles. Consequently, there was an increase in the demand for alternative insurance cover.

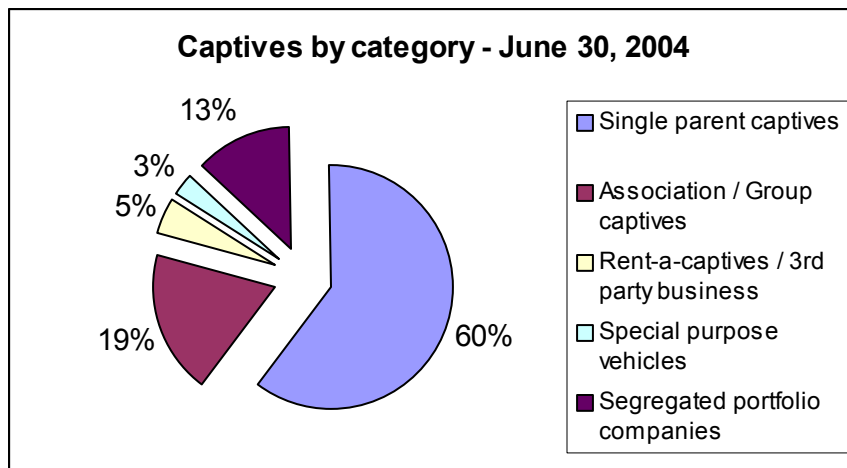
The Insurance Division issued a total of 83 new captive licenses during 2003, bringing the number of existing licenses to 644 at the end of the year. An additional 34 have been issued during the first half of 2004 for a total at June 30, 2004 of 663, writing premiums of over US\$5billion and reporting assets of more than \$20billion with shareholders’ equity of US\$4billion. Of these, 87% emanate from North America where the medical malpractice liability crisis continues to fuel their formation. The Cayman Islands, renowned for the expertise and experience in this field, has seen the percentage of new healthcare captives formed jump from 33% to 75% in the past two years. Other risk locations represented in Cayman captives include Caribbean, Latin America, Asia, Africa, Europe and the Pacific.



Sixty percent of the captives formed in the Cayman Islands are pure captives with single parent ownership. Group and Association captives make up 19% of the total.

The Segregated Portfolio Company (“SPC”) continued as a popular vehicle during the reporting period especially for large corporations wishing to offer multiple lines of cover through a captive and for those smaller corporations who use this vehicle as a stepping-stone until enough surplus

has been accumulated to justify a stand-alone captive. For the period January 2003 to June 2004, 17 new SPCs were licensed, bringing the total number licensed at June 2003 to 85 with a total of 379 segregated portfolios operating within them.



All captives licensed in the Cayman Islands are required to appoint an insurance manager within the Islands, at which office full books and records are kept. At June 30, 2004, 27 such managers were licensed.

Corporate mergers, acquisitions and strategic alliances resulted in the surrender of two approved external Class “A” Licenses during the period January 2003 to June 30, 2004. For the same period, one new approved external insurer’s license was issued and one locally incorporated Class “A” license was issued. Both of these new companies write health insurance, the latter being owned by the Government of the Cayman Islands and formed specifically to provide health insurance cover, which is mandatory in the Cayman Islands, to those individuals who are unable to secure such cover in the commercial market.

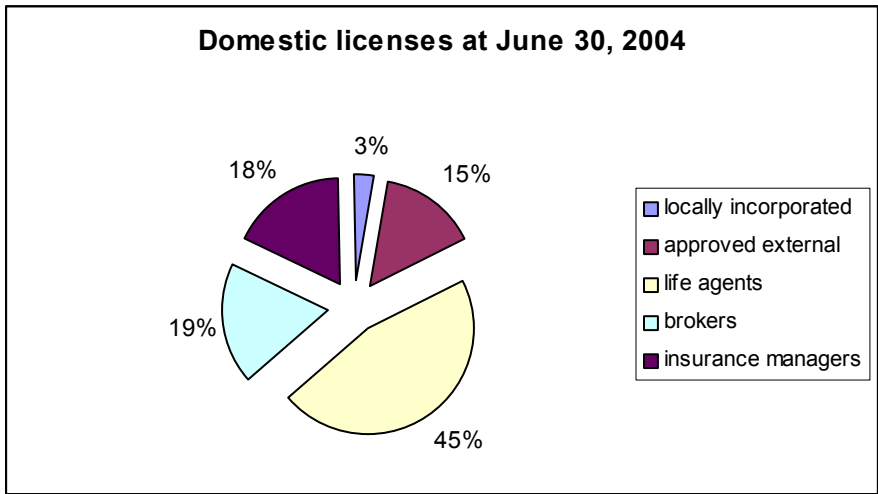
Gross written premium in the domestic market for the reporting period was CI\$213 million. Overall, domestic insurers posted better underwriting and net income results than in 2002, especially in health insurance where companies sought to steer their health portfolios into a profitable mode by a combination of premium increases and cost containment measures.

The Office of the Superintendent of Health Insurance was moved from the Cayman Islands Monetary Authority to the Ministry of Health, coinciding with amendments to the Health Insurance Law 1997 and the Health Insurance Regulations. This office, now called the Health Insurance Commission, has assumed responsibility for monitoring the health insurance market, including the approval of rate increases.

An amendment to the Motor Vehicle Insurance (Third Party) Law (1997 Revision) resulted in a cap being placed on liability in respect of death or bodily injury of CI\$1million with a CI\$5million aggregate on any one event. The Cayman Islands were one of the few jurisdictions in the Caribbean where unlimited liability was still in effect and this was resulting in problems securing reinsurance.

All insurance brokers and all life insurance agents operating within the Cayman Islands are required to be licensed. At June 30, 2004 there were 28 insurance brokers and 68 life insurance agents licensed.





**Inspection Programme**

Consistent with all other supervisory divisions within the Monetary Authority, the Insurance Division performs off-site monitoring as well as on-site inspections. Off-site monitoring includes the analysis of annual returns, approvals of business plan changes and regular meetings with the boards of directors and management of the licensees. On-site inspections allow the Authority an opportunity to fully understand the licensee’s business procedures and the risks associated with each entity. The Insurance Division carries out full inspections as well as focused inspections, which involves a specific aspect and can be performed without notice. Captive insurance companies, unless they are the subjects of a focussed inspection, are generally inspected in conjunction with their appointed insurance manager.

Since the inception of the on-site inspection programme, all domestic insurers have been the subject of a full or focussed inspection and approximately one-third of the captives have been inspected through the insurance managers.

**Regulatory Developments**

No major amendments were made to the Insurance Law (2003 Revision) during the period of the report. The latest revision brings all amendments made prior to December 2002 under one cover. However, it is very likely, as a result of the findings of the IMF’s Assessment conducted late in 2003, combined with the findings of the Task Force established by the Board of Directors, that a major review of the Insurance Law and the Insurance Regulations will be undertaken to ensure that the jurisdiction is in full compliance with international standards.

**Staffing**

The current staff complement of the Insurance Division is 10. During the reporting period, one senior analyst left the Insurance Division to join the private sector and two senior analysts were hired to work in the domestic market.



## **INVESTMENTS AND SECURITIES SERVICES**

The Investment Services Division was renamed the Investments and Securities Division (the “I&S Division”) in March 2003 in recognition of the addition of the Securities and Investments Business Law (“SIBL”) to the regulatory mandate of the Division. The I&S Division also supervises and regulates mutual funds and mutual fund administrators in accordance with the Mutual Funds Law (2003 Revision).

### **Industry Trends**

The success in the growth of the funds industry in the Cayman Islands is primarily due to the absence of a prescriptive regime mandating where the service providers should be located. In addition, the depth of relevant professional services and expertise available, and the relatively swift turnaround time in the establishment of funds in the Cayman Islands is also a significant factor in this growth.

According to the 2003 annual survey of hedge fund administrators conducted by Hedge Fund News, the majority of Cayman registered mutual funds are hedge funds, holding over 54% of the world market, and offshore hedge fund assets have continued to grow with aggregate single manager fund assets up from \$418 billion in June 2002 to \$496 billion in June 2003. The major trends of 2002 have continued into 2003 and 2004 with increasing integration between the operations of managers, prime brokers and administrators, the institutionalisation of the business and the increased due diligence requirements under anti-money laundering legislation. After four consecutive years of beating equities, hedge funds have solidified their position as a viable class and increased their attractiveness to ‘funds of funds’ investors.

The mutual fund industry in the Cayman Islands as a whole continues to grow at a steady pace with the I&S Division processing an average of 25 mutual fund applications per week. During the reporting period the number of mutual funds grew from a total of 4,285 at the end of December 31, 2002 to 5,399 as at June 30, 2004. Of the 5,399 funds, 4738 were Registered Mutual Funds, 606 were Administered Funds, and 55 were Licensed Funds.

Licences for mutual fund administration are issued in three categories, namely: Full Administrators, Restricted Administrators, and Exempted Administrators. As at June 30, 2004 the number of licences held in each category respectively was 82, 90, and 7. The most notable change in licence numbers was in respect of Restricted Administrators with the number of licensees falling by 42 during the reporting period. The primary reason for this reduction is that many of these former licence holders have now registered as Excluded Persons under SIBL by virtue of the fact that they provide investment management and/or advisory services exclusively for sophisticated persons, which includes within its definition entities regulated by the Monetary Authority.

In 2002, the requirements of the SIBL were partially implemented. Since its enactment the regulatory work of the Division in respect of SIBL focussed solely on registering persons deemed “excluded” under the Law. Under SIBL a person that carries on securities investment business in any one or more of the activities set out in Schedule 2 of SIBL is required to obtain a licence unless they are exempt from doing so. As of 30<sup>th</sup> June 2004, there are 504 Excluded Persons, and the I&S Division was processing 28 SIBL licence applications.

The Cayman Islands at present participates in the Coordinated Portfolio Investments Survey for banks only. It is the intention to have mutual funds participating by the end of 2004. To this end,

a new customised form for mutual funds (Form RF2) has been created, which will seek to obtain the information required by the International Monetary Fund as well as other statistical information on the funds and administrators that the I&S Division has deemed necessary.

### **Inspection Programme**

On-site inspections for the first half of 2003 were performed as scheduled. The last inspection took place in the third quarter of 2003. With regard to off-site reporting forms, the I&S Division is presently in consultation with industry regarding the development of prudential returns.

### **Regulatory Developments**

In October of 2003 the Board of Directors of the Monetary Authority discussed a Paper prepared by the Policy and Development Division entitled "Regulation of the Mutual Funds Industry in the Cayman Islands", which contained 28 recommendations. The Board was of the view that having regard to the significance of the recommendations it was desirable to have input from representatives of relevant private sector associations. As a consequence the following associations were invited to nominate representatives to the Mutual Funds Working Group: the Cayman Islands Fund Administrators Association, Cayman Islands Society of Professional Accountants, Cayman Islands Law Society and the Cayman Islands Bar Association.

The objective of the Working Group was to review the existing regulatory regime in the Cayman Islands in respect of Mutual Funds and Mutual Fund Administrators and to make recommendations on necessary changes to enhance the regime. The Working Group also took into account other relevant materials and recommendations including any recommendation made by the International Monetary Fund following its assessment of the Cayman Islands regulatory system in the Offshore Financial Centre assessment program. Subject to Cabinet approval, the 25 recommendations agreed by the Working Group will form the basis for reform of the Mutual Funds Law (2003 Revision).

Once the initial SIBL licence applications have been processed and licensees inspected, it is the I&S Division's intention to recommend a similar Working Group to review the existing regulatory regime in the Cayman Islands with respect to securities investment business and to make recommendations on necessary changes to enhance the regime.

### **Staffing**

The I&S Division experienced some staff losses with the total staff complement falling from 17 to 13 at the end of the reporting period. The staff shortages taken with the growth in the number of mutual funds and the additional regulatory obligations arising out of SIBL will require significant additional recruitment.

## FIDUCIARY SERVICES

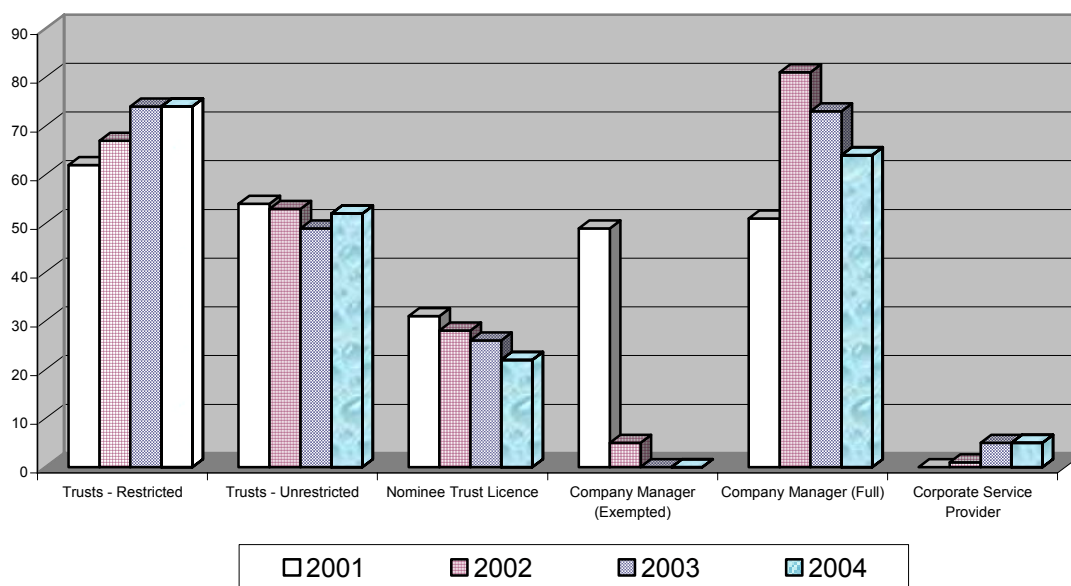
The Fiduciary Services Division is responsible for supervising and regulating company managers and all trust companies not having a banking licence including restricted trust, nominee trust and company manager licences. The Fiduciary Division performs its regulatory functions pursuant to the Banks and Trust Companies Law (2003 Revision) and the Companies Management Law (2003 Revision).

In the absence of internationally accepted core principles for trust and company services providers, the fiduciary sector has embraced the Statement of Best Practice, which was the product of the Trust and Company Service Providers Working Group that was set up by the Offshore Group of Banking Supervisors (OGBS). The working group comprised representatives of various offshore financial centres, the FATF, IMF and OECD as well as representatives of four G7 countries. The Statement of Best Practice was disseminated to the fiduciary sector via the Society of Trust and Estate Practitioners (STEP) and the Company Managers Association, and was accepted as appropriate guidelines for the proper conduct of trust and corporate business.

### Industry Trends

At the end of June 2004, there were 126 trust services providers comprised of 52 Unrestricted Trust Companies and 74 Restricted Trust Companies, compared to a total of 125 trust companies as at December 31<sup>st</sup>, 2002. A slight downward movement was evident in the number of Nominee Trusts Companies 22, and Full Company Managers, 69, compared to 25 Nominee Trust Companies and 71 Full Company Managers in December 2002. There was an increase in the number of licensed Company Services Providers from 1 as at December 31<sup>st</sup> 2002, to 5 at the end of June 2004.

Fiduciary Services Supervision Licencees



The majority of Companies Management Licence cancellations for the period were due to those licensees being successful applicants for exemptions pursuant to Schedule Four of the Securities

Investment Business Law (2003 Revision). The other cancellations resulted from the licensees' successful application for the grant of Trust Licences, which due to the exemption under the Companies Management Law (2003 Revision) negated their need to continue holding Companies Management licences.

The steady, though gradual, increase in applications made for Restricted Trust Licences strongly suggests that this jurisdiction continues to be favourably considered for the creation and administration of private wealth management structures.

Also of note is the increased popularity in special purpose structures, that are created in relation to capital markets and securitisation related transactions. The growing market for special purpose structures has generated added interest among local service providers in obtaining appropriate licensing to provide services for these structures. The Monetary Authority has also received independent representation from industry players with recommendations on how this jurisdiction could best service this growing business area.

The fiduciary sector was generally cooperative in meeting the 30 September 2003 deadline for completion of the retrospective due diligence exercise. Informal indications from industry members suggest strongly that the exercise, although costly, was successful.

### **Inspection Programme**

For the period commencing January 1<sup>st</sup> 2003 and ending in June 30<sup>th</sup> 2004, there were 26 full scope on-site inspections performed. The mix of inspections was a balanced ratio of trust companies and company managers.

The Fiduciary Services Division uses the Company Managers' Reporting Schedule for off-site monitoring of licensees under the Companies Management Law (2003 Revision). The bi-annual report provides the Fiduciary Services Division with prudential and non-prudential information, which assists in the identification of industry trends. A similar form is being developed for the purpose of off-site monitoring of trust companies.

### **Regulatory Developments**

In addition to carrying out its administrative regulatory and supervisory duties, during the period under review, the Division was involved with the International Monetary Fund's assessment of the supervision and regulation of financial sector of the Cayman Islands and participating in the Board's Task Force review of the Fiduciary Services Division and its functions.

Emanating from the on-going Task Force review is the conclusion that a more focused risk-based approach to regulation would improve the effectiveness of the Fiduciary Division's discharge of its regulatory functions, more specifically in regard to the on-site inspection programme. The Fiduciary Services Division will shortly undertake the exercise of allocating risk-based weightings to all licensees using the Board-approved risk analysis criteria.

A working group has been assembled to examine the disparity in the annual fees payable by trust companies and company services providers. The working group comprises members of the Authority and representatives of various industry associations and is chaired by the Authority's Managing Director. The working group intends to submit a report of its findings to the Cabinet through the Board upon completion of its review.

**Staffing**

During the reporting period there were no changes to either the number or composition of staff. Staffing remained at a total of seven personnel.

## NON-SUPERVISORY DIVISIONS

### COMPLIANCE DIVISION

During the reporting period of January 2003 to June 2004, the Compliance Division (or “the Division”) continued to focus on its primary responsibilities, namely:

- investigating serious breaches of the regulations and directing and administrating enforcement actions;
- researching and conducting due diligence on persons who have applied to act as directors, shareholders, managers, officers and controllers of licensed entities; and
- assisting on non-routine overseas regulatory requests.

The Division was also involved in various special projects during the reporting period, including the IMF Review and assisting the regulatory divisions on 7 onsite inspections.

The Division has a cross-functional role and works closely with the supervisory divisions as well as the Managing Director, and the Legal and Policy and Development divisions.

#### Enforcement Actions

The Monetary Authority has a range of regulatory tools available to help it meet its regulatory objectives. Where a licensee has failed to comply with the legislative or regulatory requirements, it will often be appropriate to address this without further need for formal disciplinary or other enforcement action. The Monetary Authority has issued the *Ladder of Compliance*, as part of the Regulatory Handbook, which details the steps that the Monetary Authority will follow in the event of non-compliance by a licensee or registrant.

The Compliance Division is responsible for investigating serious breaches of the regulations, collecting pertinent information and documentation, and recommending disciplinary actions, if appropriate. All enforcement actions are in conformance with the powers provided under the respective regulatory laws and the Monetary Authority will seek to ensure the fair treatment of those who are subject to the exercise of its powers. The Monetary Authority has issued the *Enforcement Manual*, which describes the policies and procedures for the exercise of the enforcement powers available to the Monetary Authority in the event of non-compliance with the regulatory laws.

The enforcement actions taken by the Monetary Authority during the reporting period are reflected in the table below:

SECTOR	REVOCATIONS	APPOINTMENT OF CONTROLLERS	APPOINTMENT OF ADVISORS	WINDING UP PETITIONS
BANKING	1	3	0	4
INSURANCE	5	2	0	2
INVESTMENTS & SECURITIES	5	2	2	1
FIDUCIARY	1	0	0	0
TOTAL	12	7	2	7

In addition to the above, one insurance licence was suspended in 2003.



## Due Diligence

The Monetary Authority has issued *Guidelines - Fitness and Propriety*, which set out the criteria the Monetary Authority will use to determine whether persons are fit and proper to act as directors, shareholders, managers, officers and controllers of licensed entities.

The Compliance Division is tasked with researching and conducting due diligence on applicants referred to them by the Regulatory Divisions. The nature and scope of the work to be performed by the Compliance Division is dependent on the risk assessment made on each application and may incorporate a range of steps including independent verification of the documentation submitted and review of public information. The Monetary Authority has issued the *Procedure – Assessing Fitness and Propriety*, which sets out the procedure the Monetary Authority will follow to assess the fitness and propriety of persons who have applied to act as or are existing directors, operators, senior officers, general partners, promoters, insurance managers or shareholders of licensed entities.

The number of due diligence applications referred to the Compliance Division by the regulatory divisions during the reporting period totalled 384. A breakdown of the due diligence requests by regulatory division is reflected in the table below:

<b>Division:</b>	<b>Banking</b>	<b>Fiduciary</b>	<b>Insurance</b>	<b>Investments</b>
<b>Number of Applications:</b>	62	213	12	97

The Compliance Division reports its findings to the supervisory divisions who then make the final decision as to applicants' fitness and propriety to act as operators, senior officers, general partners, promoters, insurance managers or shareholders of licensed entities.

## Non-Routine Overseas Regulatory Requests

The Compliance Division's mandate also includes assisting the Legal Division on non-routine overseas regulatory requests. The process includes reviewing and assessing the overseas regulatory requests to ensure they satisfy the requirements of the Monetary Authority Law (2003 Revision), as amended, and drafting directions to persons who have information that will assist the overseas regulatory authority in performing their functions. The Monetary Authority has issued the *Procedure - Dealing with Requests for Assistance from an Overseas Regulatory Authority (ORA)*, which sets out the approach of the Monetary Authority in dealing with these requests. During the reporting period the Compliance Division assisted on 11 non-routine overseas regulatory requests from 9 overseas regulatory authorities.

## MLRO for the Monetary Authority

The Head of the Compliance Division is the Monetary Authority's Money Laundering Reporting Officer (the "MLRO") under the Proceeds of Criminal Conduct Law (2001 Revision). Any suspicion of money laundering identified by the staff of the Monetary Authority in conducting their supervisory activities is reported to the MLRO, who has the responsibility to report to the Financial Reporting Authority (the "FRA") in conformance with the Money Laundering Regulations (2003 Revision). During the reporting period the MLRO filed 52 suspicious activity reports with the FRA.

## Staffing

The current staff compliment of the Compliance Division is six, comprised of a Head, 3 Senior Analysts and 2 Analysts. The current plan is to replace the Deputy Head position

with a Chief Analyst position, which the Division will be looking to fill imminently. This will take the staff compliment to the currently approved level of 7.

The Compliance Division implemented a secondment program in late 2003 as part of a training initiative for its staff to gain experience on insolvency and forensic engagements. The Monetary Authority and the 'Big 4' accounting firms have partnered in this successful initiative. To date, two staff members have been seconded for three months each and an additional secondment is planned for the second half of 2004.

## LEGAL DIVISION

The Legal Division is responsible for providing in-house legal services to the Monetary Authority. The duties of the Division include:

- a) the provision of legal advice to the Board of Directors, the Managing Director, and to the supervisory and other supporting divisions;
- b) the provision of litigation services;
- c) the development of proposals for legislative enactments or amendments to relevant laws and regulations and to provide related drafting instructions on the request of the Financial Secretary;
- d) the drafting of directives or requirements under the Monetary Authority Law (2003 Revision);
- e) the preparation of Memoranda of Understandings (MOUs); and
- f) the co-ordination of assistance to Overseas Regulatory Authorities (ORAs).

The Legal Division works closely with other sections of the Monetary Authority, including the Compliance Division on enforcement matters, and with the Policy & Development Division on the ongoing development and review of the Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands (“the Guidance Notes”).

In general, the Legal Division seeks to ensure that the Monetary Authority’s procedures permit it at all times to act within the spirit and letter of the laws governing the work of the Monetary Authority and to keep these laws under review to ensure that they remain effective.

An ongoing activity for the Legal Division is advising on and co-ordinating responses to requests for assistance from ORAs. In this regard the Legal Division works closely with the Supervisory Divisions and the Compliance Division to ensure that requests are handled in a timely and efficient manner and that they conform to the requirements of the Monetary Authority Law (2003 Revision).

Legislative proposals developed by the Legal Division in the second half of 2003 included amendments to the Monetary Authority Law to:

- a) provide for the indemnity of directors;
- b) to allow the Authority to consent to onward disclosure of information for use in criminal investigations related to breaches of foreign regulatory laws in specific circumstances and under clearly defined conditions;
- c) to extend the circumstances in which the Authority can enter into MOUs with other overseas regulatory authorities.

The Legal Division in collaboration and coordination with other Divisions of the Authority also developed proposals and participated in consultation with the financial industry on amendments to address weaknesses identified in the regulatory laws in the latter part of 2003. In the first half of 2004, the Legal Division developed proposals for Regulations pursuant to the Insurance Law to exempt Lloyd’s of London from the requirements of section 7(1) of the Insurance Law while retaining the ability of the Authority to impose appropriate requirements for the maintenance of liability support by Lloyd’s.

From 2003 to June 2004, the Legal Division drafted MOUs between the Authority and regulators in the following jurisdictions, all of which have been approved by Cabinet:

Jamaica, Bermuda, Isle of Man and Panama.

The Legal Division also participated in the drafting of a regional multi-lateral MOU to deal with cross border supervision arising out of the merger of Barclays Bank Plc and the Canadian Imperial Bank of Commerce which took place in 2003. The multi-lateral MOU has been approved by the Board of Directors and is awaiting final approval by Cabinet.

The Legal Division played a pivotal role in the Retrospective Due Diligence exercise, and worked with the offices of the Managing Director, the Financial Secretary and the Attorney General to address the issue of what action the Monetary Authority can take to deal with non-compliance with the requirement for the identification of existing clients in the Money Laundering Regulations 2000. Following discussions with the Heads of Private Sector Associations, it was agreed that a proposal for the extension to the June 30<sup>th</sup> deadline under the Money Laundering Regulation for an additional three months (until September 30<sup>th</sup> 2003) should be put to Executive Council. This was officially gazetted on June 24<sup>th</sup>, 2003.

It was also agreed that enforcement would be carried out by the Monetary Authority after the new deadline and that the sanction should be regulatory in nature and not criminal. This is now reflected in paragraphs 3.78 - 3.85 of the Guidance Notes.

The Legal Division continues to work with the Policy and Development Division and the Managing Director to address other matters related to the Guidance Notes and is actively involved in the work of the Guidance Notes Committee, which comprises representatives from the Authority, the financial industry and Government.

The Legal Division also played a leading role in the Mutual Funds Working Group, which deliberated between December 2003 and May 2004. The General Counsel from the Authority chaired the Working Group and its members consisted of representatives from the private sector as well as other senior staff from the Authority.

The Working Group's report was presented to the Board at its May 2004 meeting and has since been forwarded to Government to determine further action. The Working Group made 25 recommendations, 15 of which will involve legislative change to the Mutual Funds Law (2003 Revision) if accepted.

During the reporting period the Legal Division organised in-house training on Money Laundering and combating the financing of terrorism, the Securities Investment Business Law, and minute-taking for Secretaries to the Board and Management Committees.

The Legal Division's complement of professional and administrative staff is currently five including three lawyers, a paralegal, and a senior administrative assistant.

## **POLICY AND DEVELOPMENT**

During the reporting period the primary focus of the Policy and Development Division (or “the Division”), formerly the Policy & Research Division, continued to be the Policy Project initiated in the latter part of 2001 as part of the development of a formal regulatory framework for the Supervisory Divisions with particular emphasis on the development of guidance for the securities industry.

The following policies and guidelines were approved and posted on the Monetary Authority’s website in January 2003.

- The Ladder of Compliance Guidelines
- The Consolidated Supervision Policy
- Operational Risk Management Guidelines for banks
- Credit Risk Management Policy for banks

Following the independence of the Monetary Authority in March 2003, policies and guidance that had not yet been issued to industry were subject to a “rebadging” exercise to ensure consistency with the Monetary Authority Law (2003 Revision), as amended. Section 34 (1) to (7) of this Law, which deals with the issuing of rules, statements of principle and guidance, requires the Monetary Authority to review policies and guidelines previously issued to ensure that they are appropriately categorized. An internal committee chaired by the Legal Division was set up to devise a working definition of the different categories and a preliminary classification of existing policies and guidelines. This exercise will result in some additional consultation with the private sector particularly in cases where it is decided to develop rules which will include the imposition of penalties for the breach of rules as provided for under Section 34 (1) of the Law.

In October 2003, the following Statements of Guidance were issued pursuant to Section 34 (1) (a) of the Monetary Authority Law (2003 Revision), as amended:

- Statement of Guidance on Nature, Accessibility and Retention of Records
- Statement of Guidance on Corporate Governance
- Statement of Guidance on Licensing Banks
- Statement of Guidance on Operational Risk Management- Banks
- Statement of Guidance on Internal Controls in Banks
- Statement of Guidance on Internal Audits – Banks
- Statement of Guidance on Liquidity Risk Management – Banks
- Statement of Guidance on Interest Rate Risk Management – Banks
- Statement of Guidance on Foreign Exchange Risk Management – Banks
- Statement of Guidance on Credit Risk Management – Banks
- Statement of Guidance on Large Exposures – Banks
- Statement of Guidance on Loan Loss Provision (Allowances) - Banks
- Statement of Guidance on Licensing Money Services Businesses
- Statement of Guidance on Licensing Insurance Companies
- Statement of Guidance on Licensing Insurance Managers
- Statement of Guidance on Licensing Insurance Broker or Agent/Agency
- Statement of Guidance on Responsibilities of Insurance Managers
- Statement of Guidance on Internal Controls – Insurance

- Statement of Guidance on Market Conduct–Class A Insurers, Brokers and Agents
- Statement of Guidance on Reinsurance Arrangements – Class A Insurers
- Statement of Guidance on Asset Management & Investment Strategy For Insurance Companies
- Statement of Guidance on Licensing Company Managers and Corporate Service Providers
- Statement of Guidance on Licensing Mutual Funds
- Statement of Guidance on Licensing Mutual Fund Administrators

In January 2004 the following Statements of Guidance (“SOGs”) concerning the conduct of licensees under the Securities Investment Business Law and their officers and employees were issued:

- Statement of Guidance on Market Conduct–Securities Investment Business
- Statement of Guidance on Reorganisation of Structure and Variation of Capital – Securities Investment Business
- Statement of Guidance on Internal Controls – Securities Investment Business
- Statement of Guidance on Cessation and Non-Commencement of Business –Securities Investment Business
- Statement of Guidance on Client Assets, Money and Safekeeping – Securities Investment Business
- Statement of Guidance on Client Understanding, Suitability, Dealing and Disclosure – Securities Investment Business
- Statement of Guidance on Classification of Clients – Securities Investment Business
- The Guidance Notes on the Securities Investment Business Reporting Form.

Also issued in January 2004 was a general Statement of Guidance for licensees and registrants on Use of the Internet.

All of these Statements of Guidance can be read on the Monetary Authority’s web site under “Rules, Statements of Guidance & Principles”.

A number of other Statements of Guidance granted approval by the Board were issued for consultation. These were as follows:

#### January 2004

##### Statements of Guidance

- Cancellation of Certificates of Registration (held by mutual funds registered pursuant to Section 4 (3) of the Mutual Funds Law i.e. “registered mutual fund”)
- Cancellation of Certificates of Registration (held by mutual funds registered pursuant to Section 4 (1)(b) of the Mutual Funds Law i.e. “administered mutual fund”)
- Cancellation of Mutual Fund Licenses issued pursuant to Section 5 of the Mutual Funds Law

## March 2004:

### Rule

- Prudential Reports and Statistical Returns

### Statement of Guidance

Country Transfer and Risk Management for banks

## June 2004:

### Statements of Guidance

- Statement of Guidance on Investment Securities and Derivatives Risk Management for Banks
- Appendices of the Statement of Guidance on Client Understanding, Suitability, Dealing and Disclosure – Securities Investment Business

Another significant project of the Division in 2003 was drafting the Regulatory Handbook (“the Handbook”) issued under section 47 of the Monetary Authority Law (2003 Revision), as amended, and posted to the Authority’s web site in September 2003. The Handbook details the structure and responsibilities of the Board and Management Committee, the relationships that the Monetary Authority has with external bodies, and specific information on matters such as the licensing process, the supervisory approach, and supervisory returns. In addition the Handbook sets out the policies and procedures to be followed by the Monetary Authority, its committees, and officers in performing the regulatory and co-operative functions of the Monetary Authority. The Handbook provides a practical guide to the operations of the Monetary Authority, and transparency and accountability in the way the Monetary Authority regulates and makes decisions.

The Division continued to work with the Supervisory Divisions in the revision of the procedural manuals and in the review and updating of the Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands (the “GN”). The Division played a large role in ensuring that current risks associated with high risk countries, individuals, entities and financial products were included in the GN. A revised version of the GN was issued in September 2003. The Division is the first point of contact for GN queries and in order to expedite this function posted an Anti-Money Laundering button to the website. This provides an overview of the origins of anti-money laundering in the Cayman Islands along with a list of frequently asked questions on the GN, details on the Guidance Notes Committee, and other pertinent issues relating to anti-money laundering.

### **(Non routine) Work Programme**

To identify and outline projects and project priorities identified by the Board, the regulatory and Compliance divisions as well as Policy and Development’s review of international developments and external assessments, the Division was tasked with developing a work programme for the Policy, Strategy & Relations (“PS&R”) sub-committee. The PS&R sub-committee is responsible for:

- the development with management of the goals/mission of the Monetary Authority and the accompanying strategies, actions, and procedures;

- the development of new regulatory policies and the submission of recommendations to the Board on new regulatory policies;
- the review of policies and reports prepared by management for submission to the Board.
- 

The 2004-05 Policy, Strategy and Relations Work Programme identified proposed guidance and procedures and related tasks in the following categories:

- AntiMoney Laundering & Counter Financing of Terrorism
- General (Guidance and Procedures on regulatory matters that apply to multiple or all types of licensees)
- Banking (Guidance and Procedures related to banking institutions, money services businesses, building societies)
- Fiduciary (Guidance and Procedures related to trust companies, company managers and corporate service providers)
- Insurance (Guidance and Procedures related to insurance companies, insurance brokers, insurance managers)
- Investments & Securities (Guidance and Procedures related to regulated mutual funds, mutual fund administrators and investment securities businesses)

The PS&R Work Programme was then developed into a more comprehensive Work Programme for the Monetary Authority (for non-routine tasks and projects) and included Monetary Authority/Industry Working Group projects and Legal and legislative projects.

### **Manpower Methodology and Risk Rating Criteria**

The development of the Manpower Methodology was derived from the need for the Authority to establish a structured process that most accurately predicts the resources needed to effectively regulate the financial services industry

One component of the Manpower Methodology is the risk rating criteria. The risk rating criteria was developed to be primarily applied to on-site inspections and the frequency of prudential visits. The risk rating criteria is composed of six factors that were determined by the Monetary Authority to be of significant importance.

Other Policy & Development Division activities included in-house training on anti-money laundering, and the co-ordination of statistical returns including the submission of statistical information to external bodies and the production of the *Data Collection Update*. The aim of the *Data Collection Update* is to assist licensees who submit statistical returns to the Monetary Authority through the provision of advice addressing common problems encountered in completing the Monetary Authority's reporting schedules. The *Data Collection Update* also provides an update on any new developments on a regular basis.

In the area of statistics, the Policy & Development Division was responsible for co-coordinating the collection of statistics on Non Compliant Accounts with regard to retrospective due diligence of customers as required under the Money Laundering Regulations.

Representatives of the Division were also involved in the organisation of the Co-ordinated Portfolio Investment Survey efforts in 2003.

The Division was also responsible for the production of the Monetary Authority's publications until the Public Relations Executive took up this function in September 2003.



## **OPERATIONS**

The Operations Division is comprised of the Information Systems Unit, the Human Resources Unit and the Accounting Department.

### **Developments in Information Technology and Computer Systems**

The Information Systems Division was integrated into the Operations Division in 2003 and was renamed the Information Systems Unit. Consequently, the post of Information Systems Manager was created and filled by Rodney Ebanks, former Manager of the Systems Support Team. The Chief Operating Officer now has overall management responsibility for the Information Systems Unit.

The primary focus of the Information Systems Unit during the reporting period was the introduction of a proactive project management methodology to the Monetary Authority's information systems. This introduction resulted in the commencement of the CIISMA Assessment Project, the primary focus of which is to provide a detailed analysis and assessment of CIISMA and which will produce a detailed plan regarding future management and development of the Monetary Authority's enterprise information management system. The project is anticipated to be completed in the second half of 2004.

The development of the Monetary Authority's intranet system was also advanced during the reporting period. The first site, the Training and Development workspace, was implemented in conjunction with the Human Resources Unit, and in particular the Training & Development Specialist. Plans for the introduction of additional workspaces are planned for the next financial year.

Continuing efforts are underway to ensure the stability and responsiveness of both the information systems infrastructure and the Information Systems Unit. Key to the success of this process will be the alignment of the Monetary Authority's current information systems policies and procedures with an internationally recognized governance methodology, several of which are currently being evaluated.

During the reporting period the Information Systems Unit also played a key role in identifying and developing an enhanced business continuity plan for the Monetary Authority with a view to it being fully implemented in 2005.

### **Human Resources Developments**

The Human Resources Unit strives to be the nucleus of employees' activities and life whilst in the employ of the Monetary Authority. The mission and overall strategy of the Human Resources Unit is stated through the following:

*“The Human Resources Unit is committed to identifying and responding to the dynamic environment within which the Authority operates by ensuring that it is staffed with suitably qualified personnel.”*

The objectives of the Human Resources Unit are:

- To provide a competitive compensation package in order to attract professional individuals;

- To support continued professional development through career development planning, financial support and training;
- To encourage consistent and equitable treatment of staff across the Authority;
- To provide a confidential conduit through which employee concerns and issues can be relayed to senior management; and
- To promote the Authority as a responsible employer.

The foundation to carry forward the strategy of the Human Resources Unit was created by first computerising personnel files and then establishing, improving upon and formalising existing practices into policy.

The Human Resources Unit was further strengthened by the appointment of Anne Wylie to the newly created post of Training & Development Specialist. A major initiative, driven by Mrs. Wylie, is the Training & Development Intranet Site, which further demonstrates the Authority's commitment to be an organisation that supports ongoing learning. The site enables all employees to share and to benefit from knowledge gained at conferences, seminars, meetings and other training opportunities.

A new appraisal process was launched July 2003 to ensure that performance and behaviour focuses on the precise competencies and behaviours expected of employees. This computerised system was designed in-house and enables performance to be rewarded appropriately and objectively. This process has been in the making since 2002 and commenced with a series of workshops with staff representatives from all divisions.

### **Recruitment**

As of June 30, 2004, the total staff complement of the Monetary Authority was 92. Whilst turnover exists, a normal occurrence in large organisations, the number of employees has remained stable. The Monetary Authority acknowledges that its employees, having been well trained within the organisation and very exposed through on-site inspections, are extremely attractive to private sector employers. Nevertheless, the Monetary Authority continues to seek to recruit the most qualified, skilled and experienced individuals to fill those positions that have been vacated.

### **Changes in Management**

#### **Head of Insurance Supervision Division**

Mrs. Mary-Lou Gallegos assumed the duties and responsibilities of Acting Head of the Insurance Division following the resignation of Mr. Gordon Rowell as Head of Insurance in March 2003 and was subsequently promoted to Head of Insurance. Mrs. Gallegos has worked at the Monetary Authority since its inception in 1997 and has represented the Monetary Authority at numerous local and international conferences and events. She is the Secretary to the Offshore Group of Insurance Supervisors and has held this position since 1997. She is a member of the insurance fraud sub-committee of the International Association of Insurance Supervisors and a member of the education committee of the Offshore Group of Insurance Supervisors.

#### **Acting Deputy Head of Banking**

Malcolm Eden was appointed Acting Deputy Head of Banking Supervision effective May 2003. Mr. Eden has over seven years of experience within banking and finance. He began his career as a Bank Supervisor in June 1996, when he joined the Financial Services Supervision Department of the Cayman Islands Government. Mr. Eden's responsibilities include, among other things, leading on-site inspections, liaising with representatives from the banking sector and providing

advice and guidance on banking related matters, along with the Head of Banking, to both the Banking Supervision Division and the Board of Directors.

### **Chief Operating Officer**

Mr. Stanley Legiersky joined the Monetary Authority in August 2002. Mr. Legiersky has a wide range of experience in accounting and financial fields both within the public and private sector and worked with a number of multinational companies in the USA for over 18 years. Prior to joining the Authority Mr. Legiersky was the Financial Controller at the Civil Aviation Authority of the Cayman Islands. Mr. Legiersky graduated from the Wharton School of Business (University of Pennsylvania) with a Bachelors Degree in Economics and obtained his CPA shortly there after.

### **General Counsel**

Mr. Langston Sibblies held the position of Legal Advisor to the Monetary Authority prior to his appointment to General Counsel. He is a lawyer with over 25 years experience practising in a number of Caribbean jurisdictions and in Ontario, Canada in both the private and public sectors. In the public sector he served as Crown Counsel (Cayman) Islands, Senior Crown Counsel (British Virgin Islands), Legislative Policy Counsel (Ontario), and Director of Public Prosecutions (Grenada). In the private sector, he has worked as a Law Editor with a leading Canadian tax and business law publisher and practised as a private lawyer in Jamaica and in Toronto, Ontario. Mr. Sibblies came to the Monetary Authority in September 2000, from the Cayman Islands Government Portfolio of Finance and Development, where he served as Executive Director of The Secretariat, dealing with various international initiatives impacting on the financial industry in the Cayman Islands.

### **Head of Investments and Securities**

Gary Linford took up the post of Head of Investments and Securities in April 2004. Mr. Linford is the former global head of banking and investments of Deutsche Bank Offshore and over a 15 – year period has held senior positions with numerous multinational financial institutions in London, Hong Kong and Jersey. He attained a Master’s degree in Applied Finance from Australia’s Macquire University. Mr. Linford succeeds Mitchell Scott who is the current head of the Policy and Development Division.

### **Head of Compliance**

Robert James “RJ” Berry was appointed Head of Compliance in May 2004, following the departure of former Head Kenneth Krys. Mr. Berry, a York University graduate, has extensive experience in private banking and investment management having spent more than nine years in the local private sector prior to joining the Monetary Authority as Deputy Head of Compliance in May 2002. He is recognised by the Association of Certified Anti-Money Laundering Specialists and regularly represents the Monetary Authority at local and international anti-money laundering and anti-terrorism conferences and seminars.

### **Professional Development and Training Opportunities**

The Monetary Authority is committed to enhancing its professional base through supporting the continuous professional development of its staff. Employees are supported financially in the pursuit of their education and training on courses and programmes that are related to the work of the Monetary Authority. During the reporting period, employees were supported in their pursuit of attaining the following professional qualifications and recognised certifications:

### ***Banking Supervision***

Malcolm Eden	Master's Degree in Business Administration
Cleveland Stewart	Society of Trust and Estate Practitioners (STEP) Diploma in International Trust Management
Tara Merren	ICSA Certificate in Offshore Finance
Dianne Scott	ICSA Diploma in Offshore Finance

### ***Investments and Securities***

Judiann Richards	Bachelor of Science Degree in International Finance
Kevin Solomon	Canadian Securities Course and Securities Institute Certificate in Securities, and Certified Money Laundering Specialist (CAMS)
Judy Watler	ICSA Certificate in Offshore Finance

### ***Fiduciary***

Rohan Bromfield	STEP Diploma in International Trust Management
Leticia Frederick	STEP Diploma in International Trust Management
Jennifer Hydes	STEP Diploma in International Trust Management

### ***Operations***

Deborah Musson	Master's Degree in Human Resource Management and Development
Rodney Ebanks	Check Point Certified Security Administrator VNG
Terrence Charles	Microsoft Certified Systems Engineer

### ***Managing Director's Office***

Cindy Scotland	ICSA Diploma in Offshore Finance
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### ***Policy & Development***

Stephen Ebanks	Certified Money Laundering Specialist (CAMS)
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A strong relationship is maintained with the training facilitators of the Federal Reserve Board of Examiners, The Office of the Comptroller of the Currency, the Securities and Exchange Commission, Investment Education PLC, National Association of Insurance Commissioners, Bloomberg Caribbean, Toronto Centre, Centro de Estudios Monetarios Latinoamericanos, International Association of Insurance Fraud Agencies, who either extend an invitation to, or for whom we host training in the areas of supervision such as: credit analysis, insurance fraud, problem bank supervision, principles of fraud examination, and the capital accord, among others.

Following a request to all the local audit firms for consideration in affording senior members of the Compliance Division the opportunity of a short-term attachment, two three-month local secondments were afforded by the firms of KPMG and Deloitte. Goldman Sachs also afforded a short-term attachment for a senior member of staff from the Investments & Securities Division.

These opportunities are unique and are of mutual benefit from a regulatory point of view and that of the industry towards the exchange of experiences and skills from both sides.

### ***Internal Training Workshops***

Employees at the administrative level benefited from workshops on Customer Service and Telephone Etiquette, Communications and Business Writing and Grammar. Analysts

participated in a course entitled “Understanding Financial Statements”. Additionally, senior supervisory employees took part in an eight-week module of Supervisory Management conducted by the Training & Development Specialist.

All staff were also enrolled in a self administered, ‘sit at your desk’ Anti-Money Laundering refresher training course *Too Hot to Handle*.

As part of the orientation process all new employees are introduced to an Anti-Money Laundering workshop conducted by the Training & Development Specialist and the Policy & Development Division.

### **Internal Promotions**

During the reporting period the following employees were promoted to their respective positions in recognition of their hard work, dedication and professional achievements:

#### ***Banking***

Owen Henry	Chief Analyst
Tara Merren	Senior Analyst
Tarena Christian	Administrative Assistant

#### ***Operations***

Anne Wylie	Training & Development Specialist
Tara Ayres	Accountant
Eunice Ebanks	Accounts Clerk

#### ***Investments & Securities***

Kevin Solomon	Chief Analyst
Judiann Richards	Senior Analyst

#### ***Compliance***

Bernadette Bailey-Lewis	Senior Analyst
Tonya Bush	Analyst

#### ***Insurance***

Talia Woods	Senior Analyst
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### **Long Service Awards**

In December of 2003 the following staff was recognised for their outstanding years of dedication to the Monetary Authority and the Cayman Islands Government:

Mary Lou Gallegos	28 years
Rina Bodden	20 years
Shan Whittaker	20 years
Mitchell Scott	17 years
Anna McLean	13 years
Judith Watler	13 years
Cindy Scotland	12 years
Tara Ayres	11 years

## CURRENCY OPERATIONS

The Monetary Authority, through its Currency Operations Department, continues to be the sole issuing Authority of Cayman Islands currency. The Department is responsible for the issue, re-issue, and withdrawal of the Cayman Islands currency notes and coins against the US dollar in its dealings with the following local retail banks: Fidelity Bank, FirstCaribbean International Bank (formerly CIBC Bank & Trust Company (Cayman) Ltd. and Barclays Bank plc), Bank of Butterfield International (Cayman) Ltd., Cayman National Bank, Scotiabank, and the Royal Bank of Canada. The department also administers the sale and redemption of numismatic coins to and from local and overseas collectors.

Cayman Islands currency is issued on demand only against U.S. currency at the rate of one Cayman Islands dollar per 1.20 U.S. dollars and is repurchased on demand with U.S dollars at the same rate. The currency in circulation is backed by the Currency Reserve Assets invested primarily in US Government agency issued discount notes and mortgage-backed securities through outside Fund Managers. The investment guidelines used by the Fund Managers are security, liquidity and income. As at the end of June 2004, total Currency Reserve Assets stood at \$69.9 million representing 127.7% of currency in circulation (see Note 3 in the Notes to the Financial Statements for more details).

During the reporting period the Monetary Authority issued a re-designed \$1 banknote to commemorate the 500<sup>th</sup> Anniversary of the Cayman Islands. The \$50 and \$25 banknotes were also reprinted. A numismatic coin was also issued to commemorate the 500<sup>th</sup> Anniversary. This coin, being the first coloured coin for the Cayman Islands, depicted the Quincentennial Logo in full colour.

In 2004 gold and silver numismatic coins were issued to commemorate Her Majesty's Golden Jubilee Anniversary. This issue was the second in a two-coin series and features the Annual Chelsea Flower Show. Cayman's National Flower, the Wild Banana Orchid is also depicted on these coins. The first set of coins was issued in 2002 and featured St. Edward's Crown.

At June 30, 2004 currency in circulation (excluding numismatic coins) stood at \$48.0 million in notes and \$6.8million in coins totalling \$54.8 million. This represented a 10.5% increase from \$49.6 million the year before.

Total notes withdrawn from circulation and destroyed in the 2003/4 financial year was \$17.8 million.

## **LEGISLATIVE CHANGES**

In addition to the Monetary Authority Law (2003 Revision), legislation enacted during the reporting period includes the Securities Investment Business Law (2003 Revision) (SIBL), and the Retail Mutual Funds (Japan) Regulations (2003).

SIBL regulates those carrying on securities investments business, including market makers, broker dealers, and securities arrangers, advisors and managers. Regulations have been issued under SIBL regarding licence applications and fees, conduct of business and financial requirements and standards.

The Retail Mutual Funds (Japan) Regulations set detailed standards for Cayman funds sold to the Japanese public and thus making funds domiciled in the jurisdiction more attractive to Japanese fund distributors. These regulations establish disclosure and reporting obligations for such funds and their service providers, and the approvals required from the Authority.

## **ANTI-MONEY LAUNDERING ISSUES**

### **The Money Laundering Regulations**

The Monetary Authority is responsible for ensuring that its licensees and persons and entities conducting “relevant financial business” as defined in Schedule 2 of the Money Laundering Regulations (the “Regulations”) are in compliance with the Regulations. The legal authority to do so is contained in Section 6(1) of the Monetary Authority Law (2003 Revision), as amended.

In the first half of 2003, three amendments were made to the Regulations. Two additions were made to the Schedule 3 list of the Money Laundering Regulations. This Schedule provides a list of those countries and territories that the Cayman Islands considers to have anti-money laundering legislation of either equivalence to or greater than the Cayman Islands. Regulated entities in these countries are considered to have sufficiently rigorous anti-money laundering procedures and as such Cayman entities may rely on their due diligence. On March 10<sup>th</sup>, Austria was officially added to the Schedule 3 list under The Money Laundering (Amendment) (No.2) Regulations 2002 issued under the Proceeds of Criminal Conduct Law (2001 Revision,) and Bahrain was added on June 24<sup>th</sup> under the Money Laundering (Amendment) Regulations, 2003.

Under the Regulations all entities are required to conduct due diligence on their customers both for business relationships existing after the enactment of the Regulations in September 2000 and before. On June 24<sup>th</sup> the deadline for the completion of client identification verification by persons bound by regulation 5(1) of the Regulations for business relationships existing before the enactment of the Regulations was extended to September 30<sup>th</sup>, 2003.

### **The Guidance Notes Committee**

The Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands (GN) issued originally in June 2001 provide transparency in the interpretation and application of the Regulations. They are subject to on-going review by the Guidance Notes Committee (GNC), which is comprised of industry association representatives, government representatives and representatives from the Monetary Authority. The Policy and Development Division continued to act as Secretariat to the Committee.

During the reporting period the GNC met four times. As a result of these meetings a number of amendments were made to the GN to assist in their application and transparency, and to accommodate legislative changes. The GNC is only mandated to make amendments to the GN, and all changes to the Regulations must undergo the normal legislative process. The GNC has the power to recommend amendments to the law, which are reviewed by the Board of the Monetary Authority, and where appropriate sent to the Financial Secretary for submission to Executive Council.

### **Amendments to Guidance Notes**

A number of amendments were made to the GN in April 2003 to reflect the changes in the Regulations and to aid transparency. Particularly, the sector specific section on Mutual Funds and Mutual Funds Administrators was enhanced, and changes were made to provide greater clarity in respect of section 5: internal reporting procedures for suspicious activities. Changes were also made to section 3 of the GN - the procedures for introduced business and a sector specific section on Real Estate Business was added.

In September 2003 the GN were further amended to incorporate enhancements and amendments to provide industry with better guidance and to address certain aspects of the FATF’s Special Recommendations on Terrorist Financing.



The principal amendments to the Guidance Notes in September 2003 were:

- Addition of paragraphs dealing with Associations Not For Profit (including Charities);
- Addition of paragraphs dealing with Politically Exposed Persons;
- Addition of paragraphs dealing with High-Risk Countries;
- Addition to Section 4 on Wire Transfers; and
- Addition of new paragraphs and revision to existing paragraphs dealing with Treatment of Business Relationships Existing Prior to Enactment of the Regulations.

## **APPENDIX A – RELEVANT LEGISLATION**

The Monetary Authority Law (2003 Revision)

The Banks and Trust Companies Law (2003 Revision)

The Building Societies Law (2001 Revision)

The Cooperative Societies Law, 2001

The Money Services Law (2003 Revision)

The Insurance Law (2003 Revision)

The Mutual Funds Law (2003 Revision)

The Securities Investment Business Law (2003 Revision)

The Money Laundering Regulations (2003 Revision)

The Misuse of Drugs Law (2000 Revision)

The Confidential Relationships (Preservation) Law (1995 Revision)



Cayman Islands

Cayman Islands Monetary Authority

## **CERTIFICATE OF THE AUDITOR GENERAL**

*To the Shareholder and Directors of  
the Cayman Islands Monetary Authority*

In accordance with the Section 45(1) of the Public Finance and Audit Law (1997 Revision), I have audited the financial statements of the Cayman Islands Monetary Authority for the six month period ended 30 June 2003, as set out on pages 3 to 14.

### **Respective Responsibilities of Management and the Auditor General**

These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

### **Basis of Opinion**

My examination was made in accordance with International Standards on Auditing. Those Standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

### **Opinion**

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Cayman Islands Monetary Authority as at 30 June 2003

and the results of its operations and its cash flows for the six-month period then ended, in accordance with International Accounting Standards and comply with the Monetary Authority Law (2002 Revision).



N K Esdaile  
Auditor General  
30 October 2003



Cayman Islands Monetary Authority

## CERTIFICATE OF THE AUDITOR GENERAL

### *To the Shareholder and Directors of the Cayman Islands Monetary Authority*

In accordance with the Section 45(1) of the Public Finance and Audit Law (1997 Revision), I have audited the financial statements of the Cayman Islands Monetary Authority for the year ended 30 June 2004, as set out on pages 3 to 14.

#### **Respective Responsibilities of Management and the Auditor General**

These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

#### **Basis of Opinion**

My examination was made in accordance with International Standards on Auditing. Those Standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

#### **Opinion**

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Cayman Islands Monetary Authority as at 30 June 2004 and the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards and comply with the Monetary Authority Law (2003 Revision).

*Dan Duguay*

Dan Duguay  
Auditor General  
12 January 2005

## FINANCIAL STATEMENTS

### CAYMAN ISLANDS MONETARY AUTHORITY BALANCE SHEET

As at 30 June 2004  
(Expressed in Cayman Islands Dollars)

ASSETS	Note	30 June 2004 \$	30 June 2003 \$
<i>Currency Reserve Assets</i>			
Call Deposits	3b	990,626	953,536
Fixed Deposits	3b	1,301,897	1,293,116
Interest Receivable, Deposits		134,397	169,810
Short-Term Investments	2b, 3a	37,908,462	23,081,236
Long-Term Investments	2b, 3a	28,758,120	37,090,003
Stocks	2f, 5, 13	828,703	868,332
<i>Total Currency Reserve Assets</i>		<u>69,922,205</u>	<u>63,456,033</u>
<i>Operating Assets</i>			
Current and Call Deposits	3b	2,230,444	2,558,693
Accounts Receivable		148,736	25,403
Other Receivables and Prepayments		27,779	48,540
Fixed Assets	2e, 4	411,735	309,288
<i>Total Operating Assets</i>		<u>2,818,694</u>	<u>2,941,924</u>
<b>TOTAL ASSETS</b>		<b>72,740,899</b>	<b>66,397,957</b>
<b>LIABILITIES</b>			
Demand Liabilities, Currency in Circulation	6a	54,753,716	49,551,773
Payable to the CI Government	8b	619,881	811,802
Other Liabilities and Payables	6b	414,207	351,234
<i>Total Liabilities</i>		<u>55,787,804</u>	<u>50,714,809</u>
<b>RESERVES and CAPITAL</b>			
General Reserve	8a	8,213,057	7,432,766
Currency Issue Reserve	8c, 13	615,038	650,382
<i>Total Reserves</i>		8,828,095	8,083,148
Paid Up Capital	8d	8,125,000	7,600,000
<i>Total Reserves and Capital</i>		<u>16,953,095</u>	<u>15,683,148</u>
<b>TOTAL LIABILITIES, RESERVES and CAPITAL</b>		<b>72,740,899</b>	<b>66,397,957</b>

Signed on behalf of the Board, 11 January 2005

Michael Austin M.B.E., F.C.A.  
*Chairman*  
Cayman Islands Monetary Authority

Cindy Scotland  
*Managing Director*  
Cayman Islands Monetary Authority

**CAYMAN ISLANDS MONETARY AUTHORITY**  
**INCOME STATEMENT**

For the twelve months ended 30 June 2004.  
(Expressed in Cayman Islands Dollars)

	Note	12 months to 30 June 2004 \$	6 months to 30 June 2003 \$
<hr/>			
<b>INCOME</b>	<b>12</b>		
Government Grants	2d, 11	8,451,844	4,250,000
Investment Income	2b	1,875,075	995,200
Commission Income		543,718	308,217
Numismatic Income		103,935	18,380
Other Income		3,968	587
<i>Total Income</i>		<u>10,978,540</u>	<u>5,572,384</u>
<hr/>			
<b>EXPENSES</b>	<b>12</b>		
Salaries and Other Benefits		5,084,265	2,513,695
General and Administrative		890,726	445,134
Pension Contributions	9	625,849	383,808
Depreciation	2e, 4	154,779	92,999
Lease Rental	7	309,425	145,977
Staff Training and Recruitment		210,702	109,840
Official Travel		258,380	125,061
Management and Custody Fees	3a	109,275	54,168
Professional Fees		153,606	44,218
Directors Fees		281,219	80,047
Realised Loss on Investments		816,836	312,973
Unrealised Loss on Investments		158,306	216,945
Foreign Currency Loss	2c	0	23,784
<i>Total Operating Expenses</i>		<u>9,053,368</u>	<u>4,548,649</u>
<b>Net Income</b>		<b>1,925,172</b>	<b>1,023,735</b>

**CAYMAN ISLANDS MONETARY AUTHORITY**  
**STATEMENT OF CHANGES IN RESERVES AND CAPITAL**

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

	12 months to 30 June 2004			6 months to 30 June 2003		
	General Reserve	Currency Issue Reserve	Paid-Up Capital	General Reserve	Currency Issue Reserve	Paid-Up Capital
Balance at 1 July (1 January) :	\$7,432,766	\$650,382	\$7,600,000	\$7,745,833	\$689,959	\$7,075,000
Transfers in:						
From Net Income	1,925,172			1,023,735		
From General Reserve			525,000			525,000
Transfers out:						
To Paid-up Capital	(525,000)			(525,000)		
Contribution Payable to C I Govt	(619,881)			(811,802)		
To adjust the Inventory of Unissued Notes on hand as at 30 June		(35,344)			(39,577)	
<b>Balance at 30 June:</b>	<b>\$8,213,057</b>	<b>\$615,038</b>	<b>\$8,125,000</b>	<b>\$7,432,766</b>	<b>\$650,382</b>	<b>\$7,600,000</b>



**CAYMAN ISLANDS MONETARY AUTHORITY**  
**STATEMENT OF CASH FLOWS**

For the twelve months ended 30 June 2004.  
(Expressed in Cayman Islands Dollars)

	12 months to 30 June 2004 \$	6 months to 30 June 2003 \$
<b>Cash flows from operating activities (see note 12)</b>		
Net Income	1,925,172	1,023,735
Adjustments for items not involving cash:		
Add: Depreciation	154,779	92,999
Less: Gain on fixed assets disposal	(750)	(200)
	<hr/>	<hr/>
Operating profit before working capital changes	2,079,201	1,116,534
Net Sale of Investments	(6,495,343)	2,868,842
Interest Receivable	35,413	(53,497)
Accounts Receivable	(123,333)	218,812
Other Receivables and Prepayments	20,761	28,451
Other Liabilities and Payables	62,973	129,145
Stocks	39,629	(306,515)
	<hr/>	<hr/>
Cash generated from operations	(4,380,699)	4,001,772
Increase/(Decrease) in Demand Liabilities	5,201,943	(2,087,113)
(Decrease) in Currency Issue Reserve	(35,344)	0
	<hr/>	<hr/>
<i>Net cash from operating activities</i>	785,900	1,914,659
<b>Investing Activities</b>		
Acquisition of fixed assets	(257,226)	(59,603)
Proceeds from fixed assets disposal	750	200
	<hr/>	<hr/>
<i>Net cash provided by investing activities</i>	(256,476)	(59,403)
<b>Financing Activities</b>		
Contribution Paid to CI Government	(811,802)	(1,245,246)
	<hr/>	<hr/>
<i>Net cash used in financing activities</i>	(811,802)	(1,245,246)
	<hr/>	<hr/>
(Decrease)/Increase in cash and cash equivalents	(282,378)	610,010
<b>Movement in cash and cash equivalents</b>		
Balance at 1 July	4,805,345	4,195,335
(Decrease)/Increase	(282,378)	610,010
	<hr/>	<hr/>
<b>Balance at 30 June (Note 3b)</b>	<b>4,522,967</b>	<b>4,805,345</b>

## NOTES TO THE FINANCIAL STATEMENTS

### CAYMAN ISLANDS MONETARY AUTHORITY NOTES TO THE FINANCIAL STATEMENTS

For the twelve months ended 30 June 2004.  
(Expressed in Cayman Islands Dollars)

#### 1. Organization and Objectives

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The Cayman Islands Monetary Authority (the "Authority") was established under The Monetary Authority Law, 1996 (the "Law") on 1 January 1997. Prior to 1 January 1997, The Cayman Islands Currency Board (the "Board") was responsible for currency management and the Financial Services Supervision Department ("FSSD") was responsible for financial services' regulation in the Cayman Islands. Under the Law, the Board and FSSD were terminated and their assets, liabilities, reserves and responsibilities transferred and vested in the Authority on 1 January 1997. Under the Monetary Authority Law (2003 Revision) (the "Law (2003 revision)"), the primary objectives of the Authority were (a) to issue and redeem currency notes and coins and to manage the Currency Reserve, (b) to regulate and supervise the financial services business (c) to provide assistance to overseas regulatory authorities and (d) to advise the Cayman Islands Government on regulatory matters.

#### 2. Significant Accounting Policies

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a) Basis of preparation. The financial statements of the Authority are prepared on the accrual basis under historical cost convention and are in accordance with International Accounting Standards. The reporting currency is Cayman Islands Dollars.

b) Investments. Short-term investments are valued, on a monthly basis at amortized cost and long term investments are valued at quoted market value. Unrealized gains or losses are recorded in the income statement.

c) Foreign Currency. Foreign currency transactions are recorded at the exchange rates prevailing on the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement. Assets and liabilities are translated at the exchange rate in effect at the Balance Sheet date.

d) Government Grants. The Authority is dependent upon annual operating grants from the Cayman Islands Government to meet its obligations. The full amount of the grant is treated as income in the year of receipt.

e) Fixed Assets. Fixed Assets are stated at historical cost less accumulated depreciation. Depreciation is calculated on the straight-line method of 20% per annum for Furniture & Fixtures, Leasehold Improvements, Office Equipment and Motor Vehicle; and 25% to 33 1/3% for Computer Hardware and Software, which is sufficient to write-off the cost of the assets over their estimated useful lives.

f) Stocks. Stocks consist of silver bullion arising from the melt-down of numismatic coins, the gold and silver bullion content of the following categories of numismatic coins: coins for resale, museum items and coins awaiting melt-down and unissued currency notes. Bullion stocks are stated at year-end market values for gold and silver bullion and unrealised gain/loss are recorded in the Income Statement. The stock of unissued currency notes is stated at cost. Only the cost of notes issued into circulation is expensed on a "first in first out" basis. (See also Notes 5).

# CAYMAN ISLANDS MONETARY AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

g) Numismatic Coins. The total nominal value of numismatic coins outstanding at 30 June 2004 is \$14,731,414 (30 June 2003: \$14,781,446). No liability for redeeming numismatic coins is recognized in the financial statements, since the amount of redemption cannot be reasonably estimated and the probability of material redemption is remote. Redemption costs and sales proceeds are recorded in the income statement as incurred.

h) Cash and cash equivalents. For the purposes of the cash flow statement, cash and cash equivalents consist of current and call deposits and fixed deposits maturing within 90 days from the date of acquisition. (See also Note 3.)

i) Employee benefits. Obligations for contributions to defined contribution and defined benefits pension plans are recognized as an expense in the income statement as incurred. (See also Note 9.)

j) Comparative information. Comparative information (balance sheet items only) has been restated in respect of a change in accounting policy for Stocks. The Income Statement and the Statement of Cash Flow are not comparable due to a change in the financial year-end. (See also Note 12.)

### 3. Currency Reserve Assets

---

Section 32(7) of the Law (2003 revision) mandates the preservation of Currency Reserve Assets, separately from all other assets of the Authority. These assets are to be used to fund the Authority's currency redemption obligations and must equate in value to at least 100% of demand liabilities arising from such obligations. (See also Note 6.) They shall not be chargeable with any liability arising from any other business. After all demand liabilities are extinguished, any surplus Currency Reserve Assets would form, in part, the assets of the General Reserve. (See also Note 8a.)

Under the Law (2003 revision), sections 32(2) and 32(6) respectively, the Currency Reserve Assets are to consist of external assets (not less in value than an amount equivalent to ninety percent of demand liabilities) and local assets (not to exceed ten percent of demand liabilities.).

At 30 June 2004, the value of Currency Reserve Assets was \$69,922,205 (30 June 2003: \$63,456,033) representing 127.7% (30 June 2003: 128%) of total demand liabilities. The value of external assets equated to 123.7% (30 June 2003: 124%) while the value of local assets equated to 4% (30 June 2003: 4.2%) of demand liabilities.

Currency Reserve Assets comprise the following:

a) Investments

The principal investment objectives of the Authority are security, liquidity and income. The investment portfolio is managed by independent fund managers in accordance with investment guidelines established by the Board of Directors, in accordance with the Monetary Authority Law (2003 Revision). Management fees are calculated based on the market value of the portfolio and are payable quarterly in arrears. Either party may terminate the agreement with thirty days notice.

**CAYMAN ISLANDS MONETARY AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

Long-term investments

Long-term investments are made up of Mortgage-backed Securities stated at market value, with interest rates ranging from 1.875% to 8.0%. Maturity dates range from 01/12/2004 to 25/08/2022. Although the stated maturity date on one security is over 10 years the expected duration is less than 10 years.

	<b>30 June 2004</b>	<b>30 June 2003</b>
<i>Range of maturities:</i>	\$	\$
1 – 5 Years	21,208,487	7,800,479
6 – 10 Years	7,234,155	28,231,538
Over 10 Years	315,478	1,057,986
	<u>\$28,758,120</u>	<u>\$37,090,003</u>

Short-term investments

Discount notes / Treasury Bills		
Maturing from 01/07/04 to 22/07/04	14,658,462	5,664,569
Repurchase Agreement		
Federal Reserve at 1.1% maturing 01/07/04	23,250,000	17,416,667
	<u>\$37,908,462</u>	<u>\$23,081,236</u>
Total short-term investments, at amortized cost		
	<u>\$38,059,684</u>	<u>\$23,081,236</u>
Market value of short-term investments		
	<u>\$38,059,684</u>	<u>\$23,081,236</u>

b) Bank Deposits

The Authority maintains current, call and fixed deposits with domestic and foreign banks. Under the Law (2003 revision), domestic deposits (as part of the Currency Reserve Assets) cannot exceed 10% of demand liabilities. At 30 June 2004, domestic deposits represent 4% (30 June 2003: 4.2%) of demand liabilities.

	<b>Currency</b>	<b>30 June 2004</b>	<b>30 June 2003</b>
		\$	\$
i) <u>Operating Cash</u>			
Current account	KYD	(108,780)	(33,760)
Call deposits	KYD	2,338,924	2,592,153
Cash on hand	KYD	300	300
Operating Cash		<u>\$2,230,444</u>	<u>\$2,558,693</u>
ii) <u>Currency Reserve Assets</u>			
<i>Domestic Deposits</i>			
Call deposits	USD	878,815	776,659
Call deposits	GBP	6,733	6,051
		<i>Foreign Deposits</i>	
U.S. Federal Reserve call account	USD	99,167	84,069
Investment portfolio, call account	USD	5,911	86,757
		<u>\$990,626</u>	<u>\$953,536</u>
Total Deposits			
		<u>\$1,301,897</u>	<u>\$1,293,116</u>
Domestic Fixed deposits	USD		
		<u>\$4,522,967</u>	<u>\$4,805,345</u>
Total Operating Cash and Currency Reserve Assets			

**CAYMAN ISLANDS MONETARY AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

*Currency Reserve Assets (continued)*

Interest is paid on domestic call and fixed deposits at rates ranging from 0.25% to 0.91% (30 June 2003: 0.125% to 0.75%) per annum.

Interest of 1.1% (30 June 2003: 1.08%) p.a. is paid on foreign call deposits. Deposits with the Federal Reserve are non-interest bearing; however, excess deposit balances are invested daily in repurchase agreements.

**4. Fixed Assets**

	Furniture & Fixtures	Leasehold Improvement	Computer Equipment	Office Equipment	Motor Vehicle	Total
<b>Original Cost</b>						
Balance at 01/07/03:	\$ 423,280	\$ 422,915	\$ 708,246	\$ 220,819	\$ 24,600	\$ 1,799,860
Additions:	5,510	-	62,190	189,526	-	257,226
Disposals:	-	-	(8,797)	-	-	(8,797)
Balance at 30/06/04:	428,790	422,915	761,639	410,345	24,600	2,048,289
<b>Accumulated Depreciation</b>						
Balance at 01/07/03:	330,654	422,915	533,634	178,769	24,600	1,490,572
Depreciation expense:	40,507	-	99,947	14,325	-	154,779
Depreciation on disposals:	-	-	(8,797)	-	-	(8,797)
Balance at 30/06/04:	371,161	422,915	624,784	193,094	24,600	1,636,554
<b>Net Book Value at 30/06/04:</b>	<b>\$ 57,629</b>	<b>\$ -</b>	<b>\$ 136,855</b>	<b>\$ 217,251</b>	<b>\$ -</b>	<b>\$ 411,735</b>
Net Book Value at 30/6/03:	\$ 92,626	\$ -	\$ 174,612	\$ 42,050	\$ -	\$ 309,288

**5. Stocks**

	<b>30 June 2004</b>	<b>30 June 2003</b>
Bullion from the melt-down of coins	\$169,491	\$131,084
Coins awaiting melt-down	100,668	66,058
Coins for resale	73,398	63,509
Museum items	22,131	19,249
Inventory of unissued currency notes (see Note 13)	463,015	588,432
Total stocks	<u>\$828,703</u>	<u>\$868,332</u>

**CAYMAN ISLANDS MONETARY AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

**6. Liabilities**

a) Demand Liabilities. Demand Liabilities represents the value of notes and coins in circulation. These liabilities are fully funded by the Currency Reserve Assets

Total demand liabilities comprise:

	<b>30 June 2004</b>	<b>30 June 2003</b>
i) Currency notes in circulation	\$47,943,797	\$43,260,710
ii) Currency coins in circulation	6,809,919	6,291,063
Total	\$54,753,716	\$49,551,773

b) Other liabilities. At 30 June 2004, other liabilities included unsettled investment management and custody fees of \$27,237 (30 June 2003: \$50,132).

**7. Lease Obligation**

The Authority leases the premises used under a lease agreement dated 1 January 2002 for the total office space of 11,229 sq. ft at \$26 per sq. ft. The lease is for an initial 2-year period with 2 x 1-year options to renew. Rental payments under operating leases are charged to the income statement in equal installments over the period of the lease.

**8. Reserves and Capital**

a) General Reserve. The Authority maintains a General Reserve in accordance with Section 6(1) of the Law (2003 revision). Under Section 8, the General Reserve must be maintained at 15% of demand liabilities to provide additional funding, if necessary, for demand liabilities and obligations arising from other business of the Authority. Reserve assets are held predominantly in United States dollars, with minimal holdings in Cayman Islands dollars and British Pound Sterling.

b) Reserve Allocation. Under Section 10 of the Law (2003 revision), the net income of the Authority, after provision for all expenditure and reserves, must be allocated such that the Currency Reserve Assets represent at least 100% of demand liabilities and the General Reserve equals 15% of demand liabilities. Any surplus, after complying with these requirements, must be transferred to the General Revenue of the Cayman Islands Government. On 17 December 2004, the Board of Directors approved a transfer of \$619,881 (30 June 2003: \$811,802) to the General Revenue of the Cayman Islands Government.

c) Currency Issue Reserve. Prior to 1 January 2003 the cost of printing of notes or minting of coins (unissued and issued) was recorded against the Currency Issue Reserve (\$250,501 in 2002). The Currency Issue Reserve was set at a level deemed necessary to meet an estimated future printing or minting cost. This effectively expensed the cost of printing or minting in that period. After 1 January 2003 the cost of printing and minting is set up as a Stock of unissued currency and only the cost of currency issued into a circulation is expensed. As a result of this change the Currency Issue Reserve had to be adjusted as of 1 January 2003 by \$314,959 (the cost of currency notes printed prior to 1 January 2003 but on hand as of 1

January 2003 - see Note 13). The Currency Issue Reserve will be adjusted as these notes are issued until the stock is exhausted. The Currency Issue Reserve will then remain at \$375,000.

*d) Capital.* The authorised capital of the Authority is \$100,000,000. The Cayman Islands Government is the sole subscriber and has contributed Paid-Up Capital of \$8,125,000 as at 30 June 2004 (30 June 2003: \$7,600,000). The Executive Council of the Cayman Islands Government has committed to increasing the Paid-Up capital of the Authority to a minimum of \$10 million by the year 2008, by yearly transfers from surplus, after complying with reserve requirements.

# CAYMAN ISLANDS MONETARY AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

### 9. Pensions

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#### a) *Public Service Pensions Plan*

Pension contributions for eligible employees of the Authority are paid to the Public Service Pensions Fund (the "Fund"). The Fund is administered by the Public Service Pensions Board ("the Pensions Board") and is operated as a multi-employer non-contributory Fund, whereby the employer pays both employer and employee contributions. Prior to 1 January 2000 the scheme underlying the Fund was a defined benefit scheme. With effect from 1 January 2000 the Fund had both a defined benefit and a defined contribution element. Participants joining after that date became members of the defined contribution element.

Using the projected unit credit method of measuring costs and obligations, the amended actuarial assessment for the Authority, effective 1 January 1999, assessed the normal annual contribution to be 10.15% of pensionable emoluments, plus an additional 6.44% in respect of the Authority's unfunded past service liability (PSL), which was estimated at \$479,114. In July 2001, the minimum normal contribution requirement for Statutory Authorities was revised to 13% effective 1 January 1999. This rate includes a 1% non-retirement benefit contribution. The Authority did not accept the rate of 13% and the Pensions Board PSL calculation because the calculation included accrual for participants' pensionable service prior to 1997 when the Authority was created, for service in departments and agencies other than the Cayman Islands Monetary Authority. The Authority therefore continued to fund 6% employee and 6% employer contributions during 1999 to 2002.

In April 2003, the Pensions Fund management advised that it was agreed that the unfunded PSL would remain a central liability of the entire public sector. Accordingly there is now no requirement for the Authority to recognise any unfunded PSL in its financial statements. Pensions management also confirmed that the contribution rate would be 13% effective 1 January 1999. The Authority began recognizing the revised contribution rate of 13% from 1 January 2003. The unpaid additional 1% retirement contribution expense from 1999 - 2002 has been assessed at \$97,108 and has been recognised as an expense in these financial statements. The total amount recognised as a pension expense during 2003-4 was \$625,849 (half-year 2003: \$383,808). The pension plan has been accounted for under paragraphs 44-46 of International Accounting Standard 19 as if it were a defined contribution plan.

#### b) *Cash Supplement in Lieu of Pension*

Prior to 1 January 2000 employees on overseas and certain local contracts were not eligible to participate in the pensions schemes underlying the Fund. These employees received cash supplements of 12% (31 December 2002: 12%) of salary in lieu of pension contributions. With effect from 1 January 2000 all overseas and certain categories of locally employed staff became entitled to participate in the Defined Contribution plan. The Authority has elected to implement this option as of 1 July 2002 for contracts expiring after that day. Employees affected by such contracts will have the option to continue contributions to their existing pension schemes as long as those are properly approved or join the Fund. The Authority paid \$14,408 (30 June 2003: \$37,576) in cash supplements during the 2003-4 year in respect of these officers.



# CAYMAN ISLANDS MONETARY AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

### 10. Financial Instruments

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a) *Credit risk.* Financial assets that potentially subject the Authority to credit risk consist principally of current, call and fixed deposits, long and short-term investments, accounts and interest receivable, and other receivables and prepayments. The Authority's current, call, and fixed deposits are placed with high credit quality institutions. Credit risk with respect to long and short-term investments, accounts and interest receivable, and other receivables and prepayments is limited because the Authority only transacts business with counterparts it believes to be reputable and capable of performing their contractual obligations. Accordingly, the Authority has no significant concentrations of credit risk.

b) *Interest rate risk.* The Authority's investments and deposits are at fixed interest rates. The ranges of interest rates and maturity dates are presented in Note 3.

c) *Fair values.* The carrying amount of current, call, and fixed deposits, accounts and interest receivable, other receivables and prepayments, demand liabilities, and other liabilities and payables approximated their fair value due to the short-term maturities of these assets and liabilities. The market value of investments is presented in Note 3. The fair values of other assets and liabilities are not materially different from the carrying amounts.

### 11. Related Party Transactions

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The Board of Directors of the Authority is appointed by the Governor and consisted of the Managing Director and nine directors as of 30 June 2004. Up to 31 December 2002, the Financial Secretary by virtue of his office was one of the directors. Due to the changes in the Law (2003 Revision) and the move to make the Authority independent, the Financial Secretary will not be a member of the Board of Directors of the Authority effective January 2003.

The following Government departments/entities provided services to the Authority during 2004:

- i) Audit Office at a cost of \$25,000 (half-year 2003: \$10,350).
- ii) Public Service Pension Board (see Note 9)
- iii) Legal Department.

The Authority acts as the Government's custodian of the Cayman Islands currency as well as collector of the annual license fees and issuer of licenses relating to the financial industry. These services are provided at no direct cost to the Government.

The Authority operates on a grant from the Government to cover its Recurrent and Capital Expenditures (see Note 4 for fixed asset purchases). At the end of each financial year the Authority contributes to the government the net operating surplus after fulfilling reserve requirements.

# CAYMAN ISLANDS MONETARY AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS

For the twelve months ended 30 June 2004.

(Expressed in Cayman Islands Dollars)

### 11. 12. Comparative information

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The Monetary Authority Law (2002 Revision) changed the financial year of the Authority to end on 30 June 2003. The financial year ending 30 June 2003 was for the period of six months. As a result the Income Statement, the Statement of Cash Flow and related notes are not comparable.

### 13. Changes in accounting policy

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In the prior year (ended 30 June 2003), the Authority changed its interpretation of IAS 2 – *Inventories* to recognize the cost of all unissued currency notes as inventory (Stocks). This change has been accounted for by adjusting the opening balance of the Currency Issue Reserve at 1 January 2003 and restating the comparatives and will satisfy Government reporting requirements.

Prior to 1 January 2003, the total cost related to printing and shipping of the currency notes has been expensed when incurred. At 30 June 2003 a total of \$588,432 unissued currency notes were on hand (\$275,382 of the 31 December 2003 unissued notes and \$313,050 of unissued currency notes printed during 2003).

The changes in accounting policy, when applied to 2003 had the following impact:

	<b>Currency Issue Reserve</b>
	<b>1 January 2003</b>
Opening balance as previously reported	\$375,000
Impact of recognition of unissued currency notes as inventory	<u>314,959</u>
Restated balance	<u><u>\$689,959</u></u>

### 14. Subsequent Event

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On 11 September 2004 Cayman Islands were struck by hurricane Ivan. Despite the destructive forces of the hurricane, the Authority has not received any significant damage and was able to resume operations on 27 September 2004. This event had no financial effect on the Authority.