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By Email

Department of Financial Services Policy & Legislation
Ministry of Financial Services and Home Affairs
Cayman Islands Government
P.O. Box 136
Grand Cayman KY1-9000
CAYMAN ISLANDS

6 November 2020

Attention: DFSLegislation@gov.ky

CC: Michelle.Bahadur@gov.ky
Dax.Basdeo@gov.ky
Cayman Finance Ordinary Members
Cayman Finance Associate Members
Cayman Finance Honorary Member Associations
Cayman Finance Board of Directors

Re: Consultation - Proposed System of Oversight and Enforcement for Accounting Records Requirement

Dear Sir/Madam,

Cayman Finance and our Members appreciate the deadline extension that has allowed us the opportunity to provide feedback regarding the following legislation relating to the proposed system of oversight and enforcement for accounting records (collectively, the **Bills**).

With the benefit of the additional time, together with the input of member firms which have individually prepared and submitted comments on the Bills to the Ministry, Cayman Finance's Legislative and Regulatory Committee (the **CF LRC**) has further discussed the proposed legislation.

We respectfully submit an alternate legislative proposal regarding the method by which the goal of compliance with the recommendation of the Global Forum, that Cayman implement an effective system of oversight to ensure the availability of accounting information, can be attained with potentially less burden being imposed upon the jurisdiction and its service providers. The proposal recommendations attached would be likely to have broad support across the financial services industry.

Thank you for providing industry with the opportunity to submit comments on these very important legislative proposals. We look forward to the opportunity to continue to be part of the consultation process and please do not hesitate to let us know if you have any questions.

Yours faithfully,

Cayman Finance Legislative and Regulatory Committee



Feedback Form, Department for Financial Services

Global Forum Recommendations

The Department for Financial Services kindly requests that stakeholders provide feedback in the following table (additional rows may be added as needed). Completed forms can be emailed to DFSLegislation@gov.ky

Clause / Provision / Topic	Comments
General Comments	
<p><u>Introduction</u></p> <p>Firstly, Cayman Finance and its members extend our thanks for being provided with the opportunity to provide feedback regarding the following legislation relating to the proposed system of oversight and enforcement for accounting records (collectively, the Bills):</p> <ul style="list-style-type: none">• Companies (Amendment)(No.3) Bill, 2020• Exempted Limited Partnership (Amendment)(No.2) Bill, 2020• Limited Liability Companies (Amendment)(No.3) Bill, 2020• Limited Liability Partnership (Amendment)(No.3) Bill, 2020• Partnership (Amendment) Bill, 2020• Trusts (Amendment)(No.2) Bill, 2020• Banks and Trust Companies (Amendment)(No.2) Bill, 2020• Companies Management (Amendment)(No.2) Bill, 2020 <p>With the benefit of additional time, together with the input of member firms which have individually prepared and submitted comments on the Bills, Cayman Finance's Legislative and Regulatory Committee (the CF LRC) has further discussed the proposed legislation. We respectfully submit an alternate legislative proposal regarding the method by which the goal of compliance with the recommendation of the Global Forum, that Cayman implement an effective system of oversight to ensure the availability of accounting information, can be attained with potentially less burden being imposed upon the jurisdiction and its service providers. The proposal below would be likely to have broad support across the financial services industry.</p>	

Before we explore the Cayman Finance's proposal, it is first necessary to summarise the main concerns identified by Cayman Finance and its member firms in relation to the measures proposed by the Bills. We have not sought to include each and every concern identified within this response, as we are aware that the Department for Financial Services has received comprehensive feedback regarding the Bills from individual industry members. This response focusses on the key concerns identified by the financial services industry, at a high level.

Concerns identified by member firms

The discussion held by the CF LRC identified the following key concerns of member firms regarding the measures proposed to be introduced by the Bills:

- **Unacceptable burden placed on CSPs**

Certain of the Bills (the Banks and Trust Companies (Amendment) (No.2) Bill, 2020 and the Companies Management (Amendment) (No.2) Bill, 2020) place an obligation on Cayman corporate service providers (**CSPs**) to provide an annual declaration confirming whether or not the entities for which they provide registered office (**RO**) services are maintaining "proper" accounts. If a licensee under these laws fails to make a declaration (for example, where a licensee has been unable to obtain a back-to-back confirmation from an underlying entity), then significant penalties would be imposed, starting at one-third of the relevant licensee's licence fee.

In brief, the concerns with imposing this new requirement on certain licensees are as follows:

- Cayman CSPs are not qualified to provide any form of assessment as to whether an underlying entity for which they provide RO services is maintaining "proper" accounts and records.
- Cayman CSPs should not be penalized for the failure of the underlying entities to comply with the law applicable to those entities. In addition, the penalties proposed in the relevant Bills are disproportionate, which concern is expressed more fully below, as a single 'foot fault' could give rise to a serious penalty.
- This requirement would effectively entail the licensees 'policing' compliance by thousands of Cayman entities with the proposed new financial information filing requirements. Requiring CSPs to fulfil such a role will mean that each CSP will incur additional costs in terms of the time and, potentially, personnel and IT systems capacity, required to design, implement and maintain internal procedures which comply with the requirement. CSPs will have no way of recovering these additional costs other than by increasing their annual registered office fees, which reduces their competitiveness and the competitiveness of the jurisdiction as a whole. This concern is expanded upon below.

- **Loss of competitiveness as a jurisdiction**

The proposals suggested by the Bills will increase the number of filings to be made by each Cayman entity, as well as increase the responsibility of the Cayman CSPs in servicing their RO clients. This will mean that CSPs and the Cayman entities experience additional costs. Whilst it is generally easy to justify each incidental cost incurred in the course of operating in the Cayman Islands, the cumulative effect of each increase should be considered. In reality, each incremental cost makes Cayman a more expensive jurisdiction to operate in,

pushing people towards competitor jurisdictions.

We appreciate that this does not mean that Cayman should not continue to make every effort to become fully compliant with the OECD's international standard of exchange of information on request and automatic exchange of information (the **EOIR Standard**). However, we are not aware of competitor jurisdictions requiring all entities to maintain information regarding the financial books and records within the jurisdiction. This development is also likely to cause alarm to persons currently doing business in Cayman, who will have concerns as to the security of their financial data, whether or not such concerns are grounded in fact.

We do not suggest that measures enhancing the international reputation and transparency practices of the Cayman Islands should be restricted because such measures may not be palatable to the jurisdiction's overseas 'clients', or because our competitors may not be taking the same steps. Such competitor jurisdictions, for example, may not be under the intense scrutiny experienced by the Cayman Islands over the last couple of years (at least) and, in any event, will likely have to 'catch-up' to measures introduced by 'path-finder' jurisdictions as international standards continue to evolve. Rather, we are suggesting a legally sound and commercially acceptable approach to obtaining access to financial information which is more in-line with current international standards.

- **The proposed legislation is out of proportion to the issue identified by the Global Forum**

Based upon section A.2. (Accounting Records) of the Global Forum's report on Transparency and Exchange of Information for Tax Purposes: Cayman Islands 2017 (Second Round) (the **Second Round Report**), the Cayman Islands has a good history regarding the provision of accounting records in practice, with a failure to provide accounting records being experienced in only 1 case out of the 161 requests received during the relevant review period. This reflects that the Cayman Islands' current legislative framework is highly effective in responding to requests in practice; and this is confirmed in the Second Round Report, which records the Cayman Islands as already being largely compliant in relation to Element A.2 (Availability of accounting information) of the EOIR Standard.

Viewed against this background, the key concerns regarding proportionality are as follows:

- The recommendation contained in the Second Round Report refers to an effective system of oversight and not enforcement, when the measures proposed by the Bills include both new administrative fines and additional penalties on certain (though, possibly by error, not all) Cayman licensees providing RO services. However, Cayman Finance concurs that there needs to be a degree of enforcement in order to implement an effective system of oversight as, without this, the new regime will not have any teeth. Enforcement is, therefore, included within our proposal below. However, as noted above, we do consider that the fines proposed to be imposed on CSPs are misplaced and grossly onerous and note that the alternative solution suggested below would simplify the measures required to implement and enforce the system of oversight by removing the requirement that Cayman CSPs 'police' compliance.
- Requiring each Cayman entity – of which there are hundreds of thousands - to maintain information regarding their books and records in Cayman in order to be able to provide information in relation to each individual exchange of information (**EOI**) request places an undue and unnecessary burden on the jurisdiction, its service providers and its customers, when the underlying goal can be achieved with less impact on legitimate businesses.

- The measures proposed by the Bill would involve numerous returns, filings and annual statements being made by various entities in order to achieve the goal of effective oversight. We would suggest that a simpler solution would be more suitable here and would place less of a burden on the jurisdiction, whilst meeting the issue identified by the Global Forum.

- **Timing**

Numerous timing concerns have been raised in relation to the legislative proposals made by the Bills. These include the following:

- The Cayman Islands has very recently experienced a great deal of regulatory change which has significantly increased the reporting and regulatory burden of operating in the Islands. Whilst we acknowledge the value of the political goal of becoming compliant rather than largely compliant in all elements of the EOIR Standard, introducing additional change with immediate effect will reinforce international opinion that Cayman is currently an uncertain jurisdiction in which to conduct business, with continual change and increased cost being experienced in practice. As a result, Cayman Finance considers that the timing of introduction of any change should be very carefully considered.
- It is our respectful submission that any changes to information to be included in the annual return of a Cayman entity should not be introduced prior to year-end. As we are nearing the end of 2020 and annual return declarations and invoices will shortly be sent to clients for completion and payment, adopting any changes to the forms of annual returns (or equivalent) required to be filed in January 2021 would cause a great deal of disruption to the financial services industry and its clients. We feel this would impact extremely negatively on the jurisdiction as a whole. On that basis, we would strongly suggest that any proposed changes to the forms of annual returns be introduced with effect from (and including) January 2022.
- Concern has been expressed regarding the requirement that CSPs providing ROs to Cayman entities must provide a declaration in January of each year in relation to the filing of information with them. January in each year is already a 'crunch time' for Cayman CSPs, when annual returns must be filed with the General Registry, returns must be made to the Cayman Islands Monetary Authority in respect of regulated entities and, from 2020, economic substance notifications must be obtained from underlying clients. A Cayman CSP will need to audit its entire book of RO business in order to provide confirmation as to whether each client entity has provided the requisite accounting information. Requiring this task to be undertaken in January will have substantial operational impact.
- There are practical timing issues to be considered as to when any information should be provided by newly incorporated companies and entities which have recently changed their RO and have not provided duplicate information to their new service provider.

- **Lack of clarity over the information required to be maintained in Cayman**

The Consultation Cover Note explains that the information required to be provided at an entity's RO under the Bills is information "sufficient to disclose with reasonable accuracy the financial position of the entity". The concern with this language is that it is very vague. During the CF LRC discussions alone, various ways were suggested as possible means of complying with this requirement; including an abridged balance sheet and a one-page data collection form referred to as something akin to a "fund annual return-light". However, the concerns with

requiring the maintenance of financial information in Cayman are as follows:

- The kind of information which will be applicable to different entities will vary greatly. For example, Cayman holding companies with no substantive activities within a larger group will often be included within consolidated financial statements, but will not prepare individual accounting records as such.
- The approach taken by the directors (or equivalent) of the various Cayman entities will differ greatly, meaning that some will file minimal information and others would take a very conservative view, potentially making the position of the Cayman CSPs with whom the information is to be filed very difficult.
- This lack of clarity in imposing a new filing requirement may be damaging to the jurisdiction; especially given that the financial information which is the subject of the filing requirement is likely to be sensitive information for numerous entities doing business in Cayman.
- In any event, if an EOI request is received by Cayman in relation to a particular entity, any information filed with that entity's RO is likely to fall short of the information required to be accessed by the requesting treaty partner. This means that the Cayman authorities (and the overseas treaty partner) will likely have to contact the underlying entity in any event to obtain additional, up-to-date information, which would render the Cayman financial information filing regime largely redundant. This then goes back to the principle of ensuring that a proportionate approach is adopted.

The Cayman Finance proposal

The proposal submitted by Cayman Finance is as follows:

1. All relevant laws contain an obligation to (a) keep proper books of account and (b) where books of account are maintained outside the Cayman Islands, comply with any request from the Tax Information Authority (TIA)

The following statutes (collectively, the **Key Statutes**) already contain varying obligations in this regard:

- Companies Law (2020), section 59;
- Exempted Limited Partnership Law (2018 revision), section 21;
- Limited Liability Companies Law (2020 Revision), section 63;
- Limited Liability Partnership Law (2020 Revision), section 11;
- Partnership Law (2013 revision), section 28; and
- Trusts Law (2020 Revision), section 27A.

It is important to note that these obligations should not apply to entities which are subject to regulation by the Cayman Islands Monetary Authority (to avoid duplication) and that the provisions noted above include a record retention element.

We would propose that the relevant provisions in the Key Statutes be amended and aligned in this regard, noting, in particular that:

- (a) section 28 of the Partnership Law and section 27A of the Trusts Law should be updated to require that, where a relevant body keeps books of account outside Cayman, it must respond to any request, order or notice issued by the TIA;
- (b) section 59(2B) of the Companies Law, goes further than the corresponding provisions in the other Key Statutes by requiring entities which maintain books of account outside Cayman to provide prescribed information to their RO on an annual basis. As with the Bills, we would propose that this provision be repealed; and
- (c) these provisions will require alignment to reflect that the obligation to provide information to the TIA is not applicable to an entity which is regulated by the Cayman Islands Monetary Authority.

2. New confirmations be included in annual returns

We would propose that the Key Statutes be amended so that the annual returns submitted to the General Registry:

- (a) include confirmation of compliance with the requirement under the applicable Key Statute to maintain proper books of account;

- (b) state whether the entity is regulated by the Cayman Islands Monetary Authority, or is an entity whose financial information is included within any filings made with the Cayman Islands Monetary Authority on an annual basis¹; and
- (c) provide the name and contact details of the person who should be contacted in the event that the TIA needs to obtain financial information regarding the entity.

It is our view that the above changes will cause the underlying entities to place increased focus on the requirement to maintain proper books of account and will enable the TIA, should an EOI request be received in relation to an unregulated entity, to swiftly identify and contact the person who is best placed to provide the requisite information.

3. New administrative fines be introduced to ensure compliance and deter non-compliance

We would propose, in-line with the relevant provisions of the Bills, that a breach of the obligation under the applicable Key Statute to maintain proper books of account be made subject to the imposition of an administrative fine, with a fine equivalent to a 'minor' breach being imposed (ie, CI\$5,000).

However, we do not think that this is sufficient. In order to further foster the compliance culture within the Cayman Islands and to enable the TIA to take steps against an entity which does not provide information in response to an EOI request – which is, in reality, the mischief sought to be addressed by the Bills - we would further propose that a breach of the obligation under the applicable Key Statute to provide information to the TIA on request also be made subject to the imposition of an administrative fine, but with a discretionary fine equivalent to a 'serious' breach (ie, up to CI\$100,000). We would also query whether the Registrar should (or indeed does) have the ability to strike an entity where there has been a breach of this requirement. We consider that this kind of measure will reflect the jurisdiction's commitment to complying with its international obligations.

Conclusion

Cayman Finance has not, at this point, suggested specific drafting changes but would be extremely happy to expand upon any of the points suggested above, should additional input or clarification be desired.

Cayman Finance notes that the proposal above does not include a requirement that unregulated Cayman entities maintain certain accounting information with their RO service provider in the Cayman Islands. As discussed in detail above, we consider that such a requirement would be overly burdensome, fraught with uncertainty and disproportionate. We further note in this regard that the Consultation Cover Note states that the Ministry also considers it disproportionate for all entities to keep their books of account in the Cayman Islands or to require all entities to file financial statements annually with the Register.

¹ This is aimed at identifying those entities which are not themselves regulated, but which are included within the consolidated financial statements of regulated entities; such as down-stream holding vehicles in an investment fund structure.

However, if the Ministry considers that the best way forward for the jurisdiction will be to require the maintenance of some kind of accounting information in the Cayman Islands, Cayman Finance would strongly suggest that further industry consultation take place in relation to the appropriate form and content of any such required information.

We are, of course, at the Ministry's disposal should there be a desire to meet and discuss the proposal or any of the concerns set out above.