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Important changes for Cayman Islands Securities Investment Business Law excluded persons

JULY 2019

Entities which have been operating as "excluded persons" under the Securities Investment Business Law (SIBL) need to be aware of recent changes to SIBL requiring them to re-register as Registered Persons, new reporting requirements and potential economic substance implications.

1. Requirement for excluded persons to re-register as registered person under the amendments to SIBL

What action is required?

If a person who is carrying on securities investment business and was previously registered as an excluded person under SIBL wants to continue to carry on such business, it must re-register as a Registered Person with the Cayman Islands Monetary Authority (CIMA) by **15 January 2020**.

To re-register, an entity must complete CIMA's "Application to Re-Register under SIBL as a Registered Person" form. The form must be submitted to CIMA through its Regulatory Enhanced Electronic Forms Submission (REEFS) portal by the entity's registered office provider.

Please contact Collas Crill Corporate Services Limited ("CCCS") at regulatory@collascrill.com for advice in relation to completing the re-registration.

What are the amendments to SIBL?

Amendments to SIBL in relation to the excluded person regime were adopted on 19 June 2019. These amendments require an entity conducting securities investment business, falling within the categories listed below, to register with the CIMA by **15 January 2020** as a Registered Person. These entities were previously excluded from the requirement to be licenced.

The categories of previously excluded person who will now be required to be a Registered Person are:

(a) a company within a group of companies carrying on securities investment business exclusively for one or more companies within the same group;

(b) a person carrying on securities investment business exclusively for one or more of the following classes of persons:

- a sophisticated person;
- a high net worth person; or

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- a company, partnership or trust (whether or not regulated as a mutual fund) of which the shareholders, unit holders or limited partners are one or more person falling within (a) or (b); or

(c) a person who would be caught by the requirement to obtain a licence but who is regulated in respect of securities investment business by a recognised overseas regulatory authority in the country or territory in which the securities investment business is being conducted.

What are the key changes?

The former excluded person regime only required registration by the excluded person which would then be acknowledged by CIMA.

However, under the new Registered Person regime, registered Persons will be subject to **greater regulatory oversight** than previously as excluded persons. For example:

1. There are additional regulatory requirement imposed on Registered Persons:

(a) an applicant must satisfy CIMA that its shareholders, directors and senior officers are fit and proper;

(b) transfers and issues of shares or partnership interests must be notified to CIMA within 21 days;

(c) material Changes to the information filed in the application for registration must be notified to CIMA within 21 days;

(d) Registered Persons must segregate client funds and property from that belonging to any other client or the Registered Person itself; and

(e) Registered Persons are required to have two directors who are each individuals or one corporate director. Each director must be registered under the Directors Registration and Licensing Law (a "registered director"). Equivalent requirements apply to exempted limited partnerships and LLCs.

2. CIMA has additional powers in relation to Registered Persons:

(a) CIMA may *refuse to register* an applicant for registration or may impose additional conditions on any applicant for registration as a Registered Person;

(b) CIMA has powers to require a Registered Person to change its name in the same circumstances as it is able to for licensees (for example if it likely to deceive or mislead, it falsely connotes a connection with another person or a special status derived from Government or it includes a prescribed word or expression);

(c) CIMA has powers to require regular returns, onsite inspections or auditor's reports to determine the business of a Registered Person for the purpose of:

- assessing whether it is undertaking its authorised activities in accordance with SIBL and any regulations made under SIBL;

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- confirming that the Registered Person is complying with the Anti-Money Laundering Regulations ("AML Regulations");
- confirming that the Registered Person is of sound financial position; or
  carrying out any other functions of CIMA.

(d) CIMA has powers to require information related to the Registered Person's securities investment business;

(e) CIMA has increased enforcement powers in relation to Registered Persons including the following:

i. if it appears to CIMA that a Registered Person has failed to comply with SIBL or any other regulation made under SIBL it may issue a notice requiring remedial action; and

ii. if CIMA knows or has reasonable grounds to believe that a Registered Person:

- is insolvent;
- is carrying out business fraudulently or in a manner detrimental to the public or to the interests of its clients or creditors;
- has contravened a provision of SIBL or the AML Regulations;
- has not conducted the direction or management of its business in a fit an proper manner;
- has directors, senior officers or persons who have acquired ownership or control who are not fit and proper persons; or
- has failed to comply with any lawful direction from CIMA,

it may take any of the following actions:

- revoke or cancel the registration;
- impose conditions upon the registration;
- apply to Court for an order to protect the interests of clients or creditors;
- publish a notice of the breach in the Gazette;
- require that an auditor's report be submitted on the Registered Person's compliance with the AML Regulations;
- require the substitution of any director or officer;
- appoint a person to advise the Registered Person;
- appoint a person to assume control of the Registered Person;
- report a material contravention of the AML Regulations to the Director of Public Prosecutions;
- require such action as CIMA believes is necessary to deal with the circumstances leading to enforcement action.

(f) CIMA will have cease and desist powers where it is of the opinion that a Registered Person is committing or about to commit, an act or pursuing or about to pursue a course of conduct that is unsafe or unsound in

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conducting business as a Registered Person. A person who fails to comply with a direction given by CIMA under its cease and desist powers commits and offence and is liable to a fine of up to US$120,000 or to imprisonment for a term of five years or to both.

2. Additional AML / CFT risk reporting forms

What action is required?

As part of the risk assessment in relation to the Cayman Islands' Caribbean Financial Action Task Force Mutual Evaluation Report, the Ministry of Financial Services has issued a notice requiring all previously excluded persons to submit two AML/CFT risk reporting forms by Thursday, **15 August 2019.** CIMA is encouraging entities to report as soon as possible and not to wait until the deadline.

The forms must be submitted to CIMA through REEFS by the entity's registered office provider. If you have not already done so, please complete the AML/CFT risk reporting forms below and return them to CCCS or your registered office provider. Please contact your usual Collas Crill contact or regulatory@collascrill.com if you need assistance completing the forms.

What forms do I need to complete?

The forms are:

AIR-157-75AML Inherent Risk Securities – this form requires the entity to provide information in relation to their clients and activities.

ARC-158-75AML Risk Controls-Securities – this form requires the entity to provide information on its AML/CFT compliance programme.

Form AIR-157-75AML Inherent Risk Securities includes:

- client/customer risk: the number and type of clients or customers the entity has (such as whether they are high net worth, sophisticated persons, non-profits, politically exposed)
- organisational structure: details of the principal place of business of the entity and the countries in which the owners and controllers are located; and
- distribution channel risk: details of where clients and customers originate from (for example through introducers, online platforms or group referrals)

Form ARC-158-75AML Risk Controls-Securities includes:

- frequency of board meetings
- copies of policies and procedures and information on when they were last updated
- frequency and results of risk assessments and AML audits
- frequency and details of staff training

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- confirmation of the AML controls and monitoring including monitoring of high risk clients and sanctions screening being applied
- confirmation regarding the appointment of AML officers
- products and services risk: details of the major activities and products of the entity, information on outsourcing of any activities, types of securities managed, information on the physical presence of the entity (if any), whether the customers or clients of the entity are subject to any regulation and, if so, in which counties, whether the entity receives client funds, the types of payments accepted, countries from where client funds are received and the countries to which they are transferred.

What if an entity fails to file?

The filing of the AML/CFT risk reporting forms by the 15 August 2019 deadline is a pre-requisite to re-registration under SIBL as a Registered Person. CIMA has indicated that any entities which fail to complete and submit the AML/CFT risk reporting forms by 15 August 2019 will not be considered for re-registration as a Registered Person.

In addition CCCS is generally advising clients that as these forms are simply a request by CIMA for a summary of the entity's compliance with the existing Cayman Islands AML/CFT regime (implemented in late 2018) ("AML Regime"), that any failure to complete these forms may cause CIMA to draw an adverse inference that the entity is non-compliant with the AML Regime which may prompt further inquiries from CIMA.

In any case, the new regime empowers CIMA with wide powers of enforcement for non-compliance with the AML Regime, including the ability to levy fines against both the entity and the directors.

CIMA has reiterated that these AML/CFT risk reporting forms must be submitted by 15 August 2019 by all entities currently registered as excluded persons, *whether or not they intend to re-register by* ***15 January 2020 deadline***.

3. Registered Persons and Economic Substance

Once re-registered, registered Persons who conduct ''fund management business'' will be subject to economic substance regime ("ES Regime") and will need to comply with the economic substance test implemented by the ES Regime.

The relevant activity of "fund management business" under the ES Regime means the business of managing securities belonging to another person in circumstances involving the exercise of discretion carried on by a relevant entity licensed or otherwise authorised to conduct business under SIBL for an investment fund.

Note that the definition of ''fund management business'' differs from the definition of ''securities investment business'' under SIBL. You should take advice from your legal counsel in the Cayman Islands as to whether your entity is or will be engaged in ''fund management business''. CCCS will be happy to refer you to an attorney in Collas Crill who will be able to advise you.

What is the test for economic substance in the Cayman Islands?

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The economic substance test requires a Relevant Entity conducting a Relevant Activity to:

(a) conduct in the Cayman Islands **core income generating activities** in relation to that relevant activity;

(b) demonstrate that it is directed and managed in an appropriate manner in the Cayman Islands in relation to that Relevant Activity; and

(c) having regard to the level of relevant income derived from the Relevant Activity carried out in the Cayman Islands:

- have an adequate amount of operating expenditure incurred in the Cayman Islands;
- have an adequate physical presence (including maintaining a place of business or plan, property and equipment) in the Islands; and
- have an adequate number of full-time employees or other personnel with appropriate qualifications in the Islands.

What are Core Income generating activities?

The core income generating activities (which, if conducted, must be conducted in the Cayman Islands) of a Relevant Person conducing fund management business will include:

(a) taking decisions on the holding and selling of investments;

(b) calculating risk and reserves;

(c) taking decisions on currency fluctuations and hedging positions;

(d) preparing reports or returns, or both, to investors or CIMA.

Note that some core income generating activities may be capable of being outsourced to service providers in the Cayman Islands.

How can we help?

At Collas Crill we can provide the support or advice you need in relation to:

- the requirements to re-register as registered person
- completing the forms or updating your AML/CFT programme
- determining whether a registered person is subject to the economic substance test
- advising on additional economic substance in the Cayman Islands which may be required before re-registration

We suggest that you use the requirement to complete the AML/CTF risk reporting forms as an opportunity to review your AML/CFT compliance programme. CCCS offers a range of AML/CFT compliance support services

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and can assist with any of the following:

- reviewing and updating you AML/CFT policies and procedures
- conducting Independent AML/CFT audits
- providing AML/CFT training
- providing AML officers

Please contact your usual Collas Crill contact or regulatory@collascrill.com for further advice on this.

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COLLAS CRILL

For more information please contact:



Ian Clark

Counsel | BVI

t: +1 284 852 6347 | **e:** ian.clark@collascrill.com

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