

**CAYMAN ISLANDS MONETARY
AUTHORITY**

**ANNUAL REPORT
1 JULY 2005 – 30 JUNE 2006**



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Cayman Islands dollars
(CI\$1=US\$1.20)*

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“Our Mission...”

“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 a stable currency.”

TABLE OF CONTENTS

<i>Managing Director's Statement...</i>	1	
<i>A vibrant financial industry...</i>	5	
Sectoral Review – Banking and Related Services	6	
Sectoral Review – Fiduciary Services	10	
Sectoral Review – Insurance	13	
Sectoral Review – Investments and Securities	17	
<i>Looking back at our look forward...</i>	20	
05-06 Work Plan and Performance Summary	21	
<i>Executing our functions...</i>	29	
Monetary Functions	30	
Regulatory Functions	32	
Banking and Related Services	34	
Fiduciary Services	36	
Insurance	38	
Investment and Securities	40	
Guidance, Compliance and Enforcement	43	
Cooperative and Advisory Functions	46	
<i>Operational Support & Administration....</i>	49	
Human Resources Management and Development	50	
Information Systems	53	
Public Relations	54	
Financial Control	55	
<i>Appendix 1 – About the Monetary Authority...</i>	56	
Organizational Chart	57	
Directors and Senior Officers as at 30 June 2006	58	
Role and Functions	59	
<i>Appendix 2 – Audited Financial Statements for the Year Ended 30 June 2006...</i>	62	

INDEX OF FIGURES AND TABLES

<i>Fig. 01: Total Value of Assets and Liabilities of Cayman Islands Bank Licensees, 2001-06</i>	6
<i>Fig. 02: Active Cayman Islands Bank Licensees, 2001-06</i>	6
<i>Fig. 03: Active Cayman Islands Trust Licences by Category, 2001-06</i>	10
<i>Fig. 04: Active Company Manager and Corporate Service Provider Licences, 2001-06</i>	10
<i>Fig. 05: Licensing Activity, Class B (Captive) Insurance Companies, 2001-06</i>	13
<i>Fig. 06: Cayman Islands Domestic Insurance Licences, by Category, 2001-06</i>	13
<i>Fig. 07: Active Mutual Funds, by Category, 2001-06</i>	17
<i>Fig. 08: Active Mutual Fund Administrators, by Category, 2001-06</i>	17
<i>Fig. 09: Cayman Islands Currency in Circulation, by Month, 2002-06</i>	33
<i>Fig. 10: On-site Inspections of Banking Licensees, 2005-06</i>	34
<i>Fig. 11: Proportion of Routine to Non-routine Overseas Regulatory Authority Requests for Assistance, 2005-06</i>	47
<i>Table 01: Bank Licensing Activity</i>	7
<i>Table 02: Aggregate Retail Bank Figures, 2005 & 2006</i>	8
<i>Table 03: Bank Licence Numbers in Selected Jurisdictions, 2002-2006</i>	9
<i>Table 04: Licensing Activity of Non-bank Financial Institutions</i>	9
<i>Table 05: Trust Licensing Activity</i>	11
<i>Table 06: Company Management Licensing Activity</i>	11
<i>Table 07: Trust Licence Numbers in Selected Jurisdictions, 2001-2005</i>	12
<i>Table 08: Company Services Licence Numbers in Selected Jurisdictions, 2001-2005</i>	12
<i>Table 09: Insurance Licensing Activity 2005-06, with 04-05 and 03-04 Comparisons</i> ...	14
<i>Table 10: Captive Insurance Licence Numbers in Selected Jurisdictions, 2001-2005</i>	16
<i>Table 11: Fund Licensing & Registration Activity</i>	18
<i>Table 12: Fund Administrators Licensing & Registration Activity</i>	19
<i>Table 13: Fund Numbers in Selected Jurisdictions, 2001-2005</i>	19
<i>Table 14: Securities Investment Business Licensing & Registration Activity</i>	19
<i>Table 15: Routine Outputs and Special Projects – Key Performance Indicators</i>	27
<i>Table 16 - Financial & Personnel Resources</i>	28
<i>Table 17: Currency in Circulation at Fiscal and Calendar Year-end, 2002-06</i>	31
<i>Table 18: Framework Under Which the Cayman Islands Monetary Authority Operates</i>	33
<i>Table 19: Due Diligence Applications Referred to the Compliance Division, 2005-06</i> ...	44
<i>Table 20: Litigation Conducted by the Legal Division, 2005-06</i>	45
<i>Table 21: Staff numbers by division at 30 June 2006</i>	50
<i>Table 22: Promotions, July 2005 through June 2006</i>	51
<i>Table 23: Training Events, 2005-2006</i>	52

Managing Director's Statement...

STATEMENT BY MANAGING DIRECTOR MRS CINDY SCOTLAND

As the principal regulator of one of the world's major financial centres, the Cayman Islands Monetary Authority remains committed to its mission of providing appropriate, responsive, cost-effective and efficient supervision to facilitate the industry's growth, competitiveness and adherence to local, and appropriate international, standards.

Within this context, during the 2005-06 fiscal year we placed strong emphasis on assessing ourselves and our operating framework, on facilitating appropriate enhancements while consolidating our strengths, and on expanding our contribution to international regulatory dialogue and cooperation. We also spent much time working internally, with industry and with the Government to address local consumer issues, particularly in the insurance sector.

The Authority's first formal Look Forward plan, which grew out of the strategic plan developed in 2004-05, guided our work programme for the year under review and has provided a measure on which to assess our accomplishments for the period.

Licensing

Our core business of licensing and supervision continues to grow. As at 30 June 2006 we were overseeing in excess of 10,600 licensees/registrants, some eight percent above the 9,906 forecasted. The 2006 figure included 735 captive insurers, 277 Class B banking licensees, and 7,845 licensed, administered and registered funds. Licensing activity generated \$54 million (US\$64.8m) in fees for the Government, two percent above the CI\$49m (US\$58.8m) forecasted (reflecting, in part, an increase in mutual fund fees). We see this level of demand for licensing as an endorsement by industry of the balance CIMA strives to maintain between rules-based and risk-based regulation, and as approval of our accessibility, responsiveness and commitment to fair and appropriate regulatory standards.

Increasing supervisory efficiency

As explained in this report, the licensee risk-assessment exercise we began during the fiscal year is an important step in further enhancing the risk-based supervisory approach. We also substantially completed development of the electronic reporting system for entities governed by the Mutual Funds Law. This initiative aims to increase supervisory efficiency and the availability of statistical industry data, not only for investments but also for all sectors as we expand the system to the other CIMA divisions in due course.

Consultation and advice

Joint CIMA/industry working groups established by the Government under the Authority's chairmanship continued to review the regulatory regime for corporate service providers, insurance, and unregulated and exempt entities. The first two groups concluded their work and submitted recommendations to the Cabinet. Subsequent to the end of the fiscal year, the Government disbanded the unregulated

and exempt entities group, having determined that the work should be continued by the Secretariat of the Portfolio of Finance and Economics. Cooperation with industry covered consultation on a range of new and amended rules, statements of guidance and policies, as well as on initiatives such as the application of the new Basel II Capital Accord in this jurisdiction.

International assistance and advocacy

We continued the provision of assistance to overseas regulatory authorities, processing 107 routine and non-routine requests, and completed negotiations to implement memoranda of understanding / undertakings that provide a framework for information exchange and other assistance with authorities in Canada, Brazil and the USA.

Other international initiatives in which CIMA was involved included advocating for more jurisdictions to officially recognise their counterparts that have equivalent anti-money laundering frameworks, so as to facilitate smoother conduct of legitimate business across borders. We gained official recognition from one additional jurisdiction and continue to negotiate with other regulators in this regard. At the same time, we participated in initiatives to strengthen the international financial system against crime, such as the FATF's typology to identify and develop a framework for addressing risks associated with the use of corporate structures.

Consumer protection

The Authority's efforts to address local consumer issues, particularly in the insurance sector, resulted in the development and implementation of a number of measures. Proposed changes to the Insurance Law to make unlicensed insurers and the brokers that place business with them more accountable; to require market conduct standards; and to provide greater protection for policyholders of approved external insurers were among recommendations the CIMA/Industry Insurance Law Review Working Group made to the Government. In addition, CIMA's Statement of Guidance on Market Conduct for Class A Insurers and Agents, which was approved by the Cabinet in September 2006, and the Cayman Islands Insurance Association's code of conduct for brokers, which we helped to develop, provided standards on how providers of local insurance should conduct business with customers.

These proposals and measures were influenced in part by the findings of the earlier review of the domestic insurance industry, post Hurricane Ivan, carried out by CIMA Director Sir Alan Traill with assistance from the Insurance Supervision Division, by the experiences and concerns of consumers after the hurricane, and through industry consultation. They also reflect current international standards. We anticipate that changes to the insurance legislation will be implemented during the 06-07 financial year, and we continue to closely monitor adherence to the SOG and code.

The Authority has also taken seriously the concerns of local residents about rising interest rates and bank-to-customer communication. While CIMA does not set interest rates, we have had dialogue with the retail banks about consumer concerns and are encouraged by the CI Bankers Association's agreement to develop a code of market conduct to address these issues.

Currency management

The amount of Cayman Islands currency in circulation fell by three percent during the year to \$70.5 million (US\$84.6m) at 30 June 2006, possibly reflecting increased use of non-cash instruments. The currency reserves stood at \$90.9 million (US\$109.8m), some 29 percent above the June 2006 currency in circulation, and 24 percent above the currency in circulation at June 2005. Earnings from the investment of the currency reserves were \$3.9 million (US\$4.68m), a 52 percent increase over 2004-05.

Staffing

The year was not without its challenges for the Authority. One of these was meeting our staffing requirement, and we ended the year at approximately 17 percent below our budgeted complement of 126. This affected our achievement of performance targets such as those set for on-site inspections, but employing a risk-based approach to inspections helped to mitigate this. The Board of Directors' adoption in July 2006 of more competitive salary scales should improve our ability to retain staff and to attract new recruits. In addition to expanding our recruitment efforts, we continue to invest in staff development and retention, and to increase our use of technology where possible to boost efficiency.

I sincerely thank our staff for their professionalism and dedication that enabled us to achieve the level of performance we did. Thanks too to our directors, including Ms Letitia Solomon, Sir Alan Traill and Senator James Kelleher, whose terms ended during the period, for their interest, service and guidance to CIMA.

We owe a debt of gratitude to the various stakeholders who worked with and supported us during the year. I look forward to our relationships with you growing from strength to strength in 2006-07 and beyond.

Cindy Scotland

A vibrant financial industry...

SECTORAL REVIEW

The Cayman Islands economy has continued to benefit from the growth and sound operation of the financial industry regulated by the Monetary Authority, though the experience has varied from one sector to another. Industry performance is reviewed in the following section.

SECTORAL REVIEW: BANKING & RELATED SERVICES

SNAPSHOT

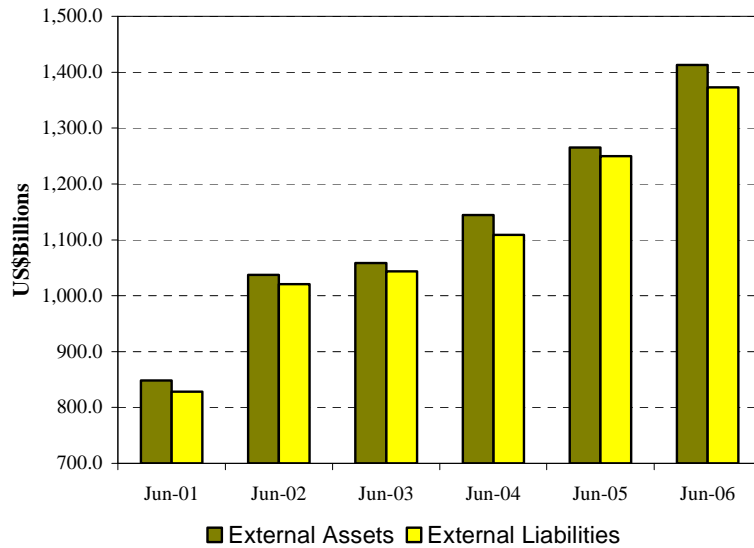


Fig. 1: Total Value of Assets and Liabilities of Cayman Islands Bank Licensees, 2001-06

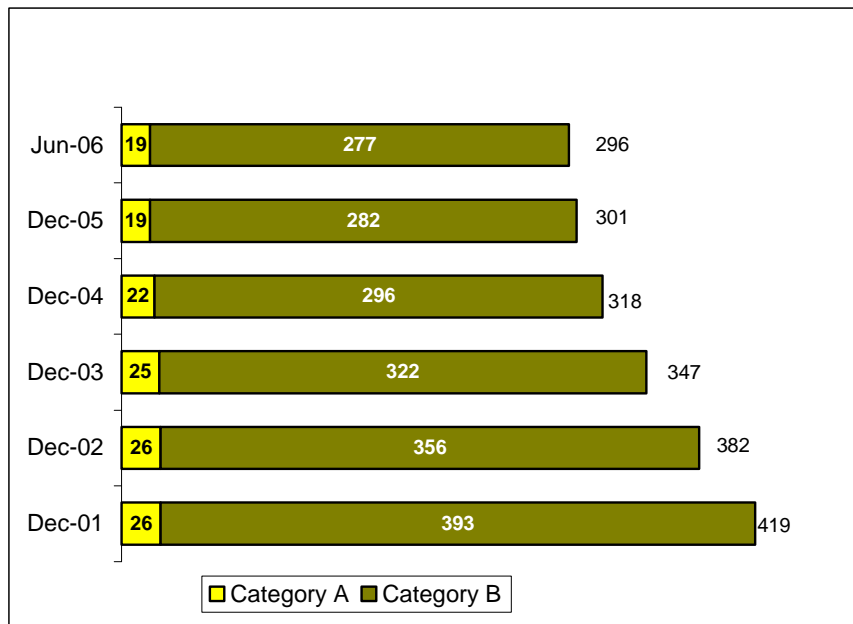


Fig. 2: Active Cayman Islands Bank Licensees, 2001-06

BANKING

Industry Trends

Restructurings, consolidations and rationalisation of banking group activities worldwide during the year drove the decline in the number of licensees in Cayman's banking sector. As at 30 June 2006 there were 296¹ institutions holding banking licences in the jurisdiction. These comprised 19 Category A licensees and 277 Category B licensees².

Table 1: Bank Licensing Activity

Licence Type	Active as at 30 June 2004	Active as at 30 June 2005	Terminated 1 Jul. 2005 - 30 June 2006	Issued 1 Jul. 2005 - 30 June. 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Category A Bank & Trust	22	22	3	1	19	19
Category B Bank & Trust	303	288	23	6	273	279
Cat B B&T (Restricted)	6	5	1	1	4	2
Total	331	315	27	8	296	300

The June 2006 figure showed 19 fewer banks than 30 June 2005, representing a six percent decline. Included in the four Category A terminations were two complete terminations, one downgrade to a Category B licence and one transfer from a banking and trust licence to a trust licence only.

Despite the decrease in the number of licensees, the jurisdiction continues to attract top tier banking groups from around the world, including Europe and North America. The seven new licences issued during 2005-06 went to well-established banking groups from Brazil and the United States of America. Of the 295 bank licensees, 182 were branches of internationally active banks, 89 were subsidiaries of internationally active banks, and the remaining 24 represented banks for which the Authority was the home supervisor.

Cayman maintained its prominence as an international banking centre, ranking as the fifth largest in the world with regards to total liabilities. International assets booked through banks in the Cayman Islands at the end of June 2006 stood at US\$1,413 billion as compared to US\$1,265 billion in June 2005 and Liabilities rose to US\$1,373 billion, up from US\$1,250 billion as at June 2005. As at 30 June 2006, the jurisdiction hosted branches or subsidiaries of over 40 of the world's top 50 banks as ranked by total assets.

¹ Including 8 licensees under termination

² The Category A banking and trust licence allows holders to operate both in the international and domestic market. The Category B licence permits international banking business and limited domestic activity.

According to the results of an economic impact study released by the Cayman Islands Bankers Association during 2006, the Cayman Islands banking sector employed 2,814 individuals, equivalent to eight percent of total employment in 2005. The study also estimated the overall impact of the banking sector at about 25 percent of the gross domestic product of the Cayman Islands, with a total impact of around US\$500 million.

The Domestic Market

The domestic market continued to be serviced by six retail banks: Butterfield Bank (Cayman) Limited, Cayman National Bank, Fidelity Bank (Cayman) Limited, FirstCaribbean International Bank (Cayman) Limited, Royal Bank of Canada, and Scotiabank & Trust (Cayman) Ltd. Four are subsidiaries of international banking groups, one is a branch of an international banking group, and the other is owned by a financial group headquartered in the Cayman Islands.

Generally, the banking sector remained well capitalized, with quality performing assets. The risk adjusted capital adequacy ratio for the five locally incorporated banks having a capital adequacy requirement was a mean average of 21 percent at June 2006. Individual capital adequacy ratios ranged from 15 to 39 percent. Table 2 shows deposit, loan and total asset figures for the six retail banks.

Table 2: Aggregate Retail Bank Figures, 2005 & 2006 (In \$US)

Year	Total Assets	Total Loans	Total Deposits
June 2006	\$ 10.7 billion	\$ 4.5 billion	\$ 9.5 billion
June 2005	\$ 9.0 billion	\$ 3.3 billion	\$ 7.9 billion

During the year under review, local interest rates increased with those in the USA (which were driven by the rising Federal Funds Rate). The effect was a marked increase in the cost of borrowed funds during the year. As such, the jurisdiction began entering a new credit cycle that will likely result in lower spending, increased savings and, possibly, reduced access to credit.

The increased cost of operating in Cayman, brought about by sharp inflation post-Hurricane Ivan, oil price increases and other factors, was a concern for banks in the jurisdiction during the year, especially for those with significant staffed premises. However, inflation, which had risen to a high of 11 percent during late 2004 to early 2005, fell steadily to 0.6 percent at June 2006. Banks also reported difficulty in attracting qualified staff both locally and from overseas, but, notwithstanding these challenges, a number of banks indicated that they would be increasing their presence in Cayman due to growth being experienced in their business.

Jurisdictional Comparisons

As illustrated in Table 3, over the five-year period, the number of banks licensed in the listed jurisdictions declined noticeably from the numbers reported in 2002.

Table 3: Bank Licence Numbers in Selected Jurisdictions, 2002-2006

Jurisdiction	2002	% change ('03 v '02)	2003	% change ('04 v '03)	2004	% change ('05 v '04)	2005	% change ('06 v '05)	2006
Cayman	383	↓ 9%	349	↓ 10%	315	↓ 2%	310	↓ 7%	287
Bahamas	193	↓ 10%	174	↓ 7%	162	↓ 2%	158	↓ 13%	137
Panama	82	↓ 7%	76	↓ 4%	73	0%	73	↑ 5%	77
Jersey	59	↓ 7%	55	↓ 7%	51	↓ 2%	50	↑ 2%	51
Luxembourg	177	↓ 5%	169	↓ 2%	165	↓ 5%	157	↓ 3%	152
Switzerland	356	↓ 4%	342	↓ 1%	338	↑ 1%	342	(1%	339
Hong Kong	224	(4%	215	(3%	208	(3%	202	(2%	198

MONEY SERVICES, CO-OPERATIVES AND BUILDING SOCIETIES

Industry Trends

The Authority issued one licence for money services business during the year, bringing the total to seven. Overseas remittances through these entities were some US\$210 million. The number of licensees under the Cooperative Societies Law (2001 Revision) and the Building Societies Law (2001 Revision) remained stable at two and one respectively.

Table 4: Licensing Activity of Non-bank Financial Institutions

Licence Type	Active as at 30 June 2004	Active as at 30 June 2005	Terminated 1 July 2005 - 30 June 2006	Issued 1 July 2005 - 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Money Services Providers	6	6	0	1	7	8
Cooperative Societies	2	2	0	0	2	2
Building Societies	1	1	0	0	1	1

Market Developments

The past year saw inquiries being received from parties interested in offering stored value cards to residents of the Islands. These cards operate in a similar manner to debit cards, with the major difference being that stored value cards' funds are placed directly to the card instead of being linked to a deposit account at a bank. The cards provide for greater flexibility and convenience than the traditional money transmission service and have arisen due to changes and demands in that market. The Authority determined that stored value cards are a means by which money transmission, as per the Money Services Law, can occur. As such, companies wishing to offer this product are subject to licensing and regulation by the Authority.

SECTORAL REVIEW: FIDUCIARY SERVICES

SNAPSHOT

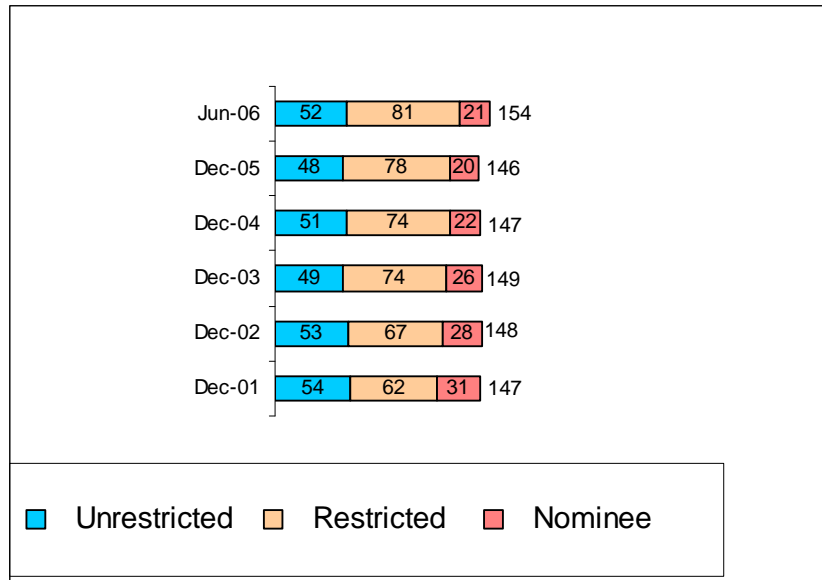


Fig. 3: Active Cayman Islands Trust Licences by Category, 2001-06

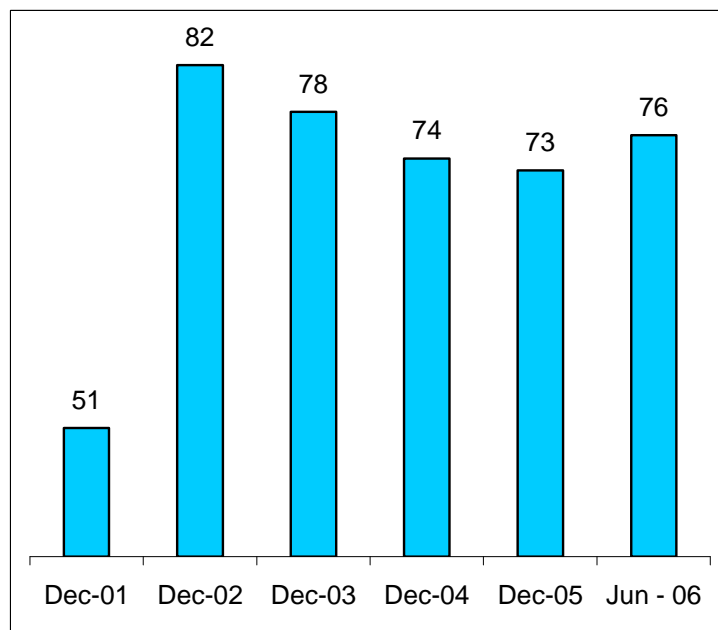


Fig.4: Active Company Manager and Corporate Service Provider Licences, 2001-06

FIDUCIARY SERVICES

Industry Trends

At 30 June 2006 there were 76 institutions holding company manager and corporate service provider licences, one more than at 30 June 2005. There were 154 entities holding pure trust licences (including restricted, unrestricted and nominee trusts). When these are added to the number of entities holding combined banking and trust licences³, the total number of trust licensees in the jurisdiction stood at some 360 at 30 June 2006.

Table 5: Trust Licensing Activity⁴

Licence Type	Active as at 30 June 2004	Active as at 30 June 2005	Terminated 1 July 2005 – 30 June 2006	Issued 1 July 2005 – 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Trust Company - Restricted	74	78	3	6	81	78
Trust Company - Unrestricted	51	48	0	2	52*	51
Nominee Trust	22	20	0	0	21*	20
Total	147	146	0	8	154	149

* Includes licences for which regulatory responsibility was transferred from the Authority's Banking Supervision Division.

That the restricted trust company is the jurisdiction's most popular trust structure is reflected in the fact that over the past four-and-a-half years this category of licence has increased by 23 percent. The issuing of six restricted trust company licences in the 2005-06 fiscal year reflects the industry's continued interest in the use of this type of licence.

Licensing activity in the unrestricted and nominee categories has been more erratic. The increase of four additional unrestricted trust company licences and one additional company manager licence did not reflect new entrants to the sector. Instead, they were new licences issued or changes in licence category as a result of restructuring of business activities. For example, two of these unrestricted trust licences and one associated nominee trust licence were for entities which previously held banking and trust licences but which surrendered their banking licences during the year.

Table 6: Company Management Licensing Activity

Licence Type	Active as at 30 June 2004	Active as at 30 June 2005	Terminated 1 July 2005 – 30 June 2006	Issued 1 July 2005 – 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Company Manager	69	70	3	4	71	69
Corporate Service Provider	5	5	0	0	5	5
Total	74	75	3	4	76	74

³ See Sectoral Overview – Banking Services, page 7.

⁴ Excludes entities retaining banking and trust licences

Jurisdictional Comparisons

Tables 7 and 8 show the number of active trust and corporate services licences in Cayman and other international financial centers for the past five calendar years.

Table 7: Trust Licence Numbers in Selected Jurisdictions, 2001-2005

Jurisdiction	2001	% change ('02 v '01)	2002	% change ('03 v '02)	2003	% change ('04 v '03)	2004	% change ('05 v '04)	2005
Cayman	409	↓ 6%	385	↓ 7%	373	↓ 5%	354	↓ 0.5%	352
Bahamas	278	↓ 20.5%	221	↓ 6%	208	↓ 5%	197	↓ 3%	191
Bermuda	N/A		N/A		N/A		N/A		33
British Virgin Islands	181	↓ 2%	178	↓ 12%	204	↑ 16%	236	↓ 10%	212
Gibraltar*	83	↓ 6%	78	0%	78	↑ 3%	80	↑ 2.5%	82
Guernsey	N/A		N/A		202	↓ 0.5%	201	↓ 1%	199
Isle of Man	N/A		N/A		N/A		N/A		18
Jersey	121	↑ 102%	245	↑ 1%	248	↓ 23%	190	↓ 3%	184
Panama	20	↓ 5%	19	↓ 10%	17	↓ 12%	15		14 (Jun 05)
Turks and Caicos	N/A		22		N/A		N/A		14

Table 8: Company Services Licence Numbers in Selected Jurisdictions, 2001-2005

Jurisdiction	2001	2002	2003	2004	2005
Cayman	72 (5 Exempted)	78	73	74	70
British Virgin Islands	14	18	18	19	20
Gibraltar*	83	78	78	80	82
Isle of Man	N/A	N/A	161	171	176
Jersey**	121	245	248	190	184
Turks and Caicos	N/A	30	N/A	N/A	N/A

Note:

*Gibraltar's figures are a total of company management and professional trustee licences that were issued as of the specified year.

**Jersey's figures include both trust and company business licensed.

SECTORAL REVIEW: INSURANCE

SNAPSHOT

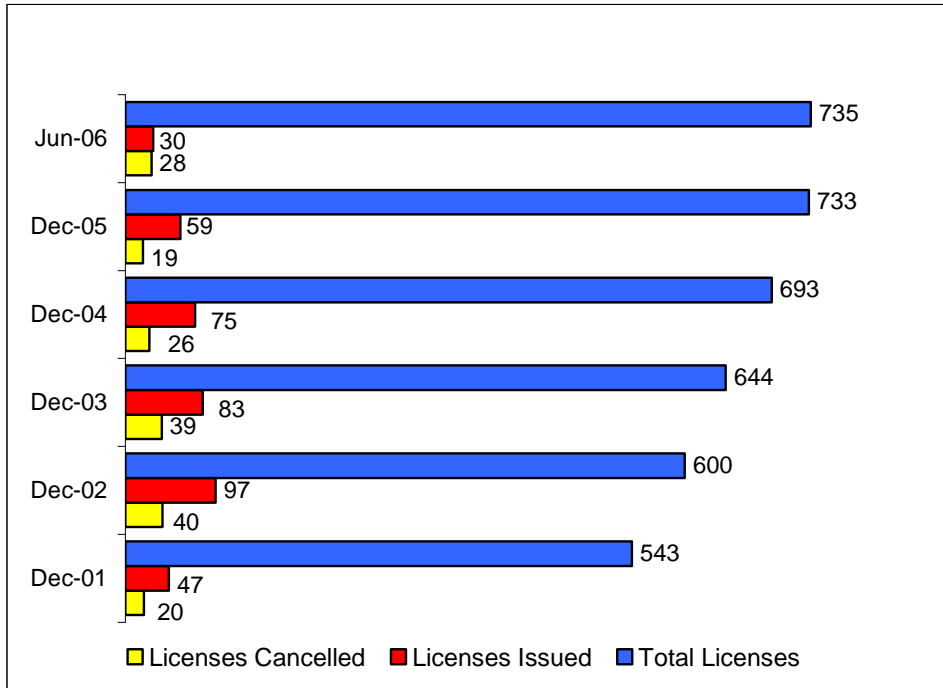


Fig. 5: Licensing Activity, Class B (Captive) Insurance Companies, 2001-06

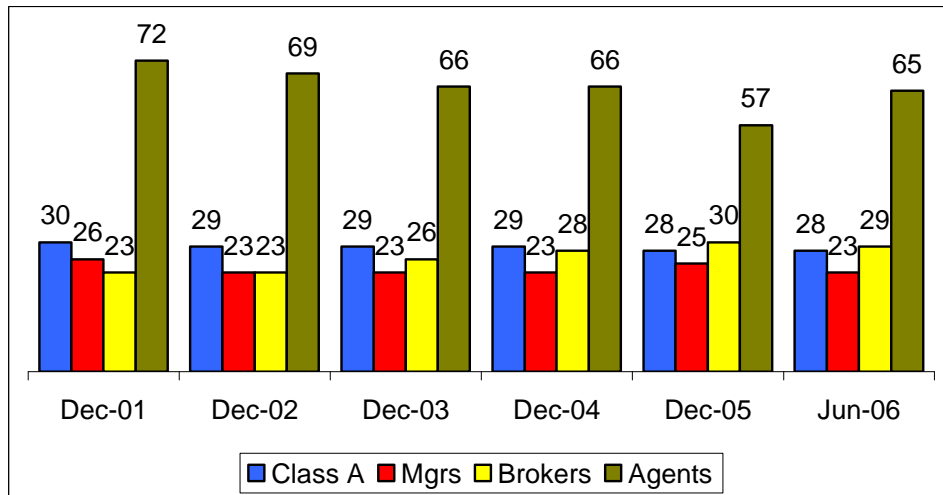


Fig. 6: Cayman Islands Domestic Insurance Licences, by Category, 2001-06

INSURANCE

Industry Trends

Captives

The captive⁵ market continued to show a high level of activity in 2005, with 59 new captive licences issued. Taking into consideration the 19 cancelled during this period, the result was a net growth of 40, the largest net growth in all captive domiciles for the calendar year. This has been achieved despite sharply increased competition from on-shore domiciles, specifically those USA states that recently enacted captive legislation.

For the period 1 January to 30 June 2006 a further 30 new captive licences were issued and 28 cancelled, the latter being the result of the Authority's cancellation of licences that have been inactive for a period of time. The total number of captive insurance companies at 30 June 2006 was 735. Of this number, 111 are segregated portfolio companies under the Companies Law (2004 Revision), with a total of 459 segregated portfolios operating within them. During 2005-06, six captive insurance companies' licences were revoked but the majority of cancellations resulted from companies being wound down due to changes in market conditions, changes in strategic direction or other changes at parent company level.

The region of origin of Cayman captives at fiscal year-end was: North America, 88 percent; Latin America and the Caribbean, four percent; Africa, Asia and the Middle East, two percent; Europe, two percent; rest of the world, four percent.

Four additional insurance managers were licensed during the year, a significant show of continued confidence in the stability and expected growth of the captive market. Licensing activity with other intermediaries was relatively static, with the agent licence numbers in Table 9 reflecting changing of agents from one company to another rather than any significant number of new licences. A full listing of all entities licensed under the Insurance Law (2004 Revision) can be found on the Authority's website at www.cimoney.com.ky.

Table 9: Insurance Licensing Activity 2005-06, with 04-05 and 03-04 Comparisons

Licence Type	Active as at 30 June 2004	Active as at 30 June 2005	Terminated 1 July 2005 - 30 June 2006	Issued 1 July 2005 - 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Class A	29	29	3	2	28	29
Class B	663	710	35	62	737	680
Insurance Managers	22	23	4	4	23	23
Brokers	28	29	2	2	29	28
Agents	65	57	8	16	65	65
TOTAL	807	846	12	19	882	825

⁵ Insurance companies operate within the Cayman Islands as Class A Insurers (writing domestic business) or Class B Insurers (writing non-domestic business only and commonly known as captive insurance companies).

Domestic

There were 28 active Class A licences at the fiscal year's end, three having been terminated and two issued during the period. Domestic insurance companies recorded a combined net earned premium of \$72.6 million for the period ending 30 June 2006, with a combined net income of \$32.2 million. Further details are available on the CIMA website.⁶

Market developments

Domestic Consumer Issues

The report on the Review of Domestic Insurance Industry - Post Hurricane Ivan, which had been commissioned by Government and carried out by CIMA Director Sir Alan Traill with assistance from the Insurance Supervision Division, was released in July 2005 and was the subject of consultation with industry and interested members of the public to identify where the legislation needed to be amended or introduced. The review had been conducted to investigate claims of widespread underinsurance in the market, the application of the average clause as a result of this underinsurance, and the loss adjusting/claims settling process, all of which had caused additional distress for homeowners in the post-hurricane period.

The report recommended several changes to increase consumer protection, including amendments to improve the processing, assessment, arbitration and resolution of claims, the provision of greater and clearer information to customers, and increasing the proportion of professionally qualified personnel in entities.

Insurance providers agreed to voluntarily implement some of the recommendations and they began work, with CIMA's assistance, on a code of conduct for brokers. At the same time CIMA developed a statement of guidance (SOG) on market conduct for insurers and agents. The SOG included requirements for insurers and agents to be properly trained, to act with integrity, skill, care and diligence; to make full, fair and easy-to-understand disclosure of information to clients, to minimize the risk of conflicts of interest, and to have a clear complaints handling procedure in place. The code was approved by Cabinet and issued subsequent to the end of the fiscal year. The code for brokers was also finalised by the Cayman Islands Insurance Association. (See "Regulatory Developments" in the Insurance chapter later in this report.)

Open Market Reinsurance

Greenlight Re, the first open market reinsurer to be licensed in the Cayman Islands, began operations during the first quarter of 2005-06 in a move seen as an endorsement of the jurisdiction's capacity to be a centre for reinsurance. The company subsequently received A ratings from A.M. Best.

Cayman Captive Forum

The Insurance Managers Association of Cayman (IMAC) staged the Cayman Captive Forum in December. Attracting over 530 delegates, including representatives of existing captives and new prospects, the conference was the biggest conference ever

⁶ <http://www.cimoney.com.ky/section/regulatoryframework/sub/default.aspx?section=ID&id=61>

in the Cayman Islands in terms of attendance. Both the Cayman Islands Government and the Authority were among the participants.

Education Standard for Captive Industry Personnel

Efforts to introduce a minimum education standard for captive industry personnel progressed. Following the Captive Forum, a number of insurance managers, working through IMAC's education committee, agreed to sponsor staff to obtain the Vermont-based International Centre for Captive Education's Associate in Captive Insurance designation. One manager volunteered as faculty of the institution.

SPVs and Sidecars

The jurisdiction saw increasing interest in special purpose vehicles (SPVs), with eight being formed during 2005-06. These vehicles provide securitization of insurance risks by providing access to capital markets. For the issuer, they effectively provide collateralized reinsurance while minimizing the counter-party risk. Sidecars are a relatively new development and are also typically structured through an SPV. They enable specialist investors to put money into the catastrophe element of the portfolio of an established reinsurance company without the exposure to the whole business.

Jurisdictional Comparisons

Table 10: Captive Insurance Licence Numbers in Selected Jurisdictions, 2001-2005

Jurisdiction	2000	2001	2002	2003	2004	2005
Cayman	516	543	600	644	693	733 (↑15%)
Bermuda*	1564	1602	1602	1284	1266	1281 (↑1%)
BVI*	181	262	246	309	346	381 (↑10%)
Vermont*	361	387	438	507	524	542 (↑3%)

* Source: *Captive and ARTReview* and AM Best

SECTORAL REVIEW: INVESTMENTS & SECURITIES

SNAPSHOT

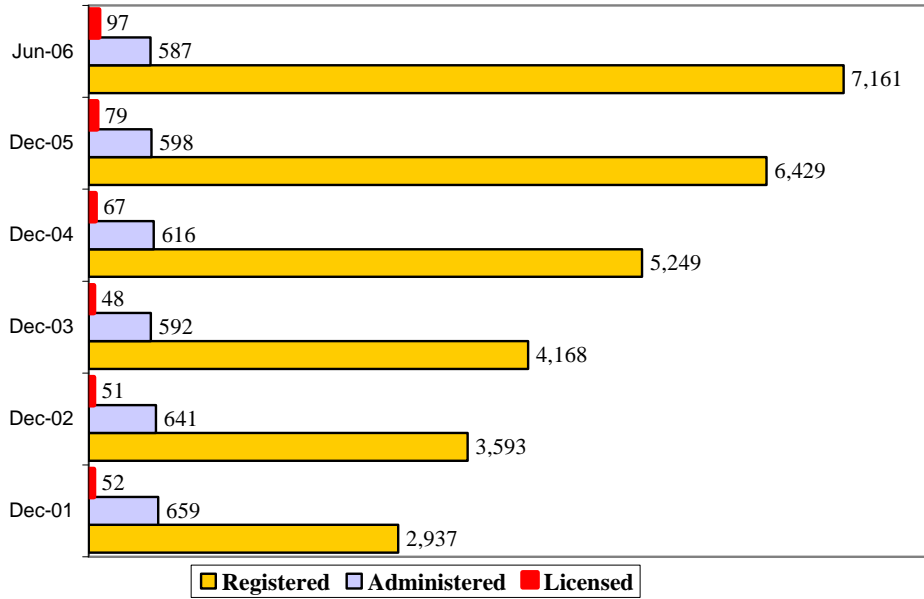


Fig. 7: Active Mutual Funds, by Category, 2001-06

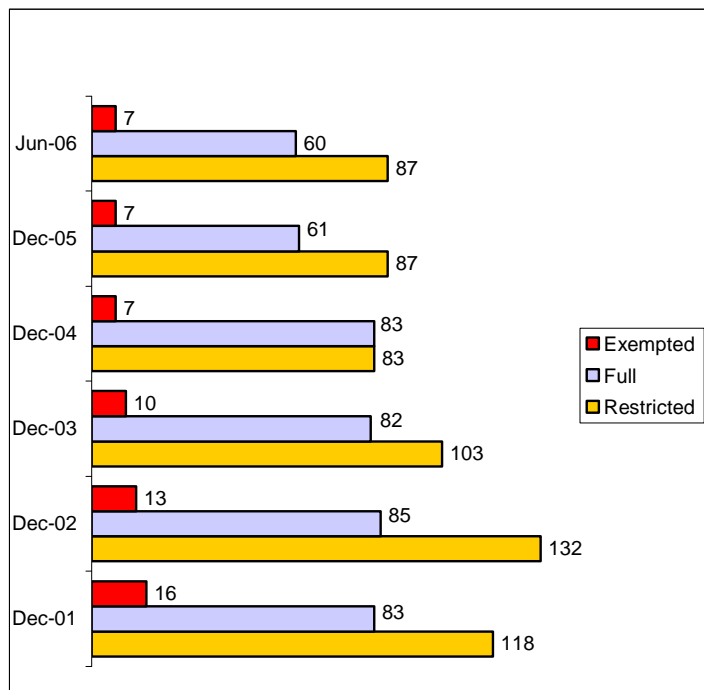


Fig. 8: Active Mutual Fund Administrators, by Category, 2001-06

FUNDS

Industry Trends

While world hedge fund performance this year has been mixed, a large number of global hedge fund indices have outperformed major market indices. In addition, there has been no slow down in the assets allocated to hedge funds or in the number of new funds set up in the Cayman Islands. Hedge fund performance can be very difficult to track, partly because most are private and not required to report their performance, resulting in different hedge fund indexes reporting different results.

Hedge Fund Manager magazine's sixth bi-annual survey of 48 fund administrators⁷ shows hedge fund assets (single funds and funds of funds) surpassed the US\$2.5 trillion mark, an increase of some 17 percent since the November 2005 survey. Despite the inevitable double-counting of assets by administrators with fund-of-fund and master-feeder structures, this rate of growth is also reflected in the increase in Cayman Island regulated funds, with the Authority processing an average of 36 fund applications per week in the 2005-06 fiscal year compared to 27 in the prior year.

The number of Cayman regulated funds grew by 20 percent from 6,527 at 1 July 2005, to 7,845 at 30 June 2006, a net increase of 1,318 (see Table 11). The Authority expects to end calendar year 2006 with approximately 8,200 active funds.

The absence of a prescriptive regime mandating where professional fund service providers should be located, the depth of relevant professional services and expertise available, and the relatively swift turnaround time in the establishment of funds in the Cayman Islands continues to drive this growth in Cayman regulated funds.

Table 11: Fund Licensing & Registration Activity

Authorization Type	Active as at 30 June 2004	Active as at 30 June 2005	Issued 1 July 2005 - 30 June 2006	Terminated 1 July 2005 - 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Registered	4738	5842	1827	508	7161	7000
Administered	606	598	37	48	587	600
Licensed	55	87	29	19	97	70
Total	5399	6527	1893	575	7845	7670

Fund Administrators

Hedge Fund Manager's sixth bi-annual survey of offshore fund administrators shows the top 15 administrators responsible for more than 80 percent of the US\$2.5 trillion hedge fund assets, with 12 of these administrators holding a mutual fund administrators licence issued by the Authority.

As a consequence of the growth in hedge funds globally, and the regulatory focus on valuation practices, the Cayman Islands continues to see an interest by new fund administrators that wish to establish a physical presence in the jurisdiction. In the last 12 months the Authority has licensed five new administrators. Table 12 shows licensing activity in each category.

⁷ May 2006 edition

Table 12: Fund Administrators Licensing & Registration Activity

Authorization Type	Active as at 30 June 2004	Active as at 30 June 2005	Issued 1 July 2005 – 30 June 2006	Terminated 1 July 2005 – 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Full	82	83	5	1	87	80
Restricted	90	70	1	11	60	65
Exempted	7	7	0	0	7	7
Total	179	160	6	12	154	152

The most notable change was in respect of restricted administrators, with the number falling by 10, to 60. The primary reason is that many of these former licensees have now registered as excluded persons under the Securities Investment Business Law (“SIBL”) since they provide investment management and/or advisory services exclusively for sophisticated persons, which includes within its definition entities regulated by CIMA.

Local Market Developments

Local AIMA Chapter – The Authority was instrumental in the establishment of the Alternative Investment Managers Association Cayman. The founding committee was agreed in May 2006 and the first function for Cayman members was held in late-June.

Jurisdictional Comparisons

Table 13: Fund Numbers in Selected Jurisdictions, 2001-2005

Jurisdiction	2001	% change ('02 v '01)	2002	% change ('03 v '02)	2003	% change ('04 v '03)	2004	% change ('05 v '04)	2005
Cayman	3648	↑17%	4285	↑12%	4808	↑23%	5932	↑20%	7106
Bahamas	673	↑5%	706	0%	707	↑19%	838	↓15%	709
Bermuda	890	↑2%	912	↑12%	1022	↑5%	1076	↑10%	1182
BVI	1975	0%	1977	↓2%	1934	↑10%	2138	↑11%	2372
Dublin	952	↑3%	981	↑1%	992	↓1%	987	↓2%	964
Jersey	327	↑37%	449	↑34%	602	↑38%	833	↑16%	965

SECURITIES INVESTMENT BUSINESS

The registration of excluded persons under the Securities Investment Business Law (SIBL) has grown in line with the growth in funds and totalled 1,209 as at 30 June 2006. This excluded person category is a key part of the success of the mutual funds regime over the past three years. By contrast, the Authority is not seeing much interest in the full SIBL licence and does not expect much growth in this area.

Table 14: Securities Investment Business Licensing & Registration Activity

Authorization Type	Active as at 30 June 2004	Active as at 30 June 2005	Issued 1 July 2005 - 30 June 2006	Terminated 1 July 2005 - 30 June 2006	Active as at 30 June 2006	Forecasted for 30 June 2006
Registered/ excluded persons	504	798	411	0	1209	800
Licence/ Full	20	24	1	0	25	25
Total	524	822	412	0	1234	825

*Looking back at our look
forward...*

**2005-06 WORK PLAN
AND
PERFORMANCE SUMMARY**

05-06 WORK PLAN & PERFORMANCE SUMMARY

To fulfil its mission the Authority annually reviews its strategic goals and objectives, adopts specific strategies and tactics, and translates these into non-routine projects. These, along with the Authority's routine responsibilities, become its work programme for the year. The work programme is documented in the Authority's *Look Forward Report* and is published on the website. The following is a synopsis of the report, with a summary of year-end status of projects, key performance indicators and financial and personnel resources.

GOAL 1:

Create a high quality and effective regulatory environment to attract users and providers of financial services.

Objective 1:

- To ensure that the laws and regulations and scope of supervision are in line with international standards that are appropriate for the Cayman Islands.

Strategies

- Implement a process to evaluate existing legislation and propose as necessary, changes in relation to international standards relevant to the Cayman Islands financial industry.
- Implement an on-going process of review in order to ensure that the supervisory process is competitive in comparison with other offshore jurisdictions

Tactics

- Set up working parties (on a cross divisional basis) headed by a representative from the Management Committee ("MC"); conduct comparative studies of the laws and regulations of other jurisdictions; identify shortcomings of own legislation (from compliance cases, on-site inspections etc) in the review process; advise the Cabinet, through the Financial Secretary, of proposals to amend or introduce legislation to address any deficiencies identified.
- Set up working parties (on a cross divisional basis) headed by a representative from the MC; conduct comparative studies of the supervisory process in other jurisdictions in order to evaluate the appropriateness of the supervisory process in respect of both international standards and from a competitive stance.

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Completion and submission of internal task force reports to Government	Project complete.
Continued assessment of regulatory laws and regulations against international benchmarks relevant to the Cayman Islands financial industry	Ongoing
Enactment of technical amendments to regulatory laws (as agreed with the industry and Government)	CIMA provided input on the drafting of amendments to the banks and trust companies, Insurance, and mutual funds laws
Consultation with industry and Government on Post Ivan Insurance Report	Complete

Working Group on Unregulated & Exempt Entities and Corporate Service Providers	Await clarification on terms of reference from Government. <i>[Subsequent event: Group disbanded; Secretariat of the Finance Portfolio to complete review]</i>
Working Group on Insurance Law (to review and report on proposed recommendations for change)	Report with recommendations submitted to the Government.
Creation of data base of competitor jurisdiction fees	Initial database created. Enhancement ongoing
Creation of data base of laws and regulations of competitor jurisdictions	Initial database created. Enhancement ongoing
Issuance of Statement of Guidance on Business Continuity Plans	Research underway
Issuance of Rule for filing of statutory returns by all licensees.	Deferred pending related amendments to the Monetary Authority Law and the Insurance Law
Consultation with industry on Basel II	Consultation ongoing
Consultation with industry on proposed Rules for banks regarding credit risk, interest rate risk, large exposures, loan loss provisioning, liquidity risk, country risk and investments risk	Consultation process completed. Rules to be issued before end of 2006
Consultation with industry on proposed Statement of Guidance or Rule of on market risk for banks	In progress

Objective 2:

- To assist overseas regulators in a manner consistent with Cayman Islands laws.

Strategy

- Enhance international regulatory co-operation through the development and application of a clear and transparent process for providing assistance under the laws of the Cayman Islands.

Tactic

- Negotiate and devise Memorandum of Understanding (“MOU”) and other agreements, which are congruent with Cayman laws with relevant parties.
- Establish a centralized internal filing system for the accurate maintenance of overseas requests for assistance, MOUs and other documentation facilitating ease of access and retrieval for appropriate Monetary Authority users.
- Establish internal procedures and performance standards for responding to information requests.

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Pursuance of membership in IOSCO	Negotiations with IOSCO are ongoing.
Negotiation of MOUs with various qualified foreign regulators.	MOUs signed: Central Bank of Brazil; Office of the Superintendent of Financial Services (OSFI) Canada.
Analysis of cross-border exchange of information regimes in other relevant jurisdictions	Ongoing

Objective 3:

- To be responsive to appropriate needs of the market.

Strategy:

- Monitor the local and international market in order to identify and understand the needs of stakeholders both locally and internationally.

Tactic:

- Conduct regular meetings with stakeholders; monitor developments in local and international markets; conduct Cost Benefit Analysis in order to identify appropriate action.

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Review and report on Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands (to assess the effectiveness and cost-benefits of the Guidance Notes with the aim of developing a more sophisticated risk-based approach.)	Preliminary research on other jurisdictions' approach is being conducted.
Issuance of specific AML guidance to money service businesses	Draft guidance being revised following review by the Guidance Notes Committee.
Issuance of enhanced guidance to the insurance industry on customer identification	Draft guidance being revised following review by the Guidance Notes Committee.
Working Group on trust company and company managers' fees	Report with recommendation drafted for forwarding to the Cabinet
Consideration of new category of trust licences (for special or single purpose vehicles, debt-issuing trustee, and for unit trusts)	Draft paper prepared and being revised and referred to Working Group on Unregulated Entities.
Issuance of consultation paper on licensing policy and criteria for privately owned banks	Review of policy in progress

GOAL 2:

To operate the Monetary Authority in the most efficient way possible.

Objective 1:

- To secure adequate resources and deploy them efficiently in the fulfillment of the Monetary Authority's mandate.

Strategy:

- Identify the resources needed to satisfy the Monetary Authority's mandate.
- Enhance dialogue with the Cabinet in order to ensure that the Cabinet is fully aware of the resource needs of the Monetary Authority.

Tactic:

- Monitor and evaluate the effectiveness of existing resources in meeting the agreed outputs of the Monetary Authority against pre-determined performance and efficiency indicators. Identify any shortfalls and/or inefficiencies in resource utilization.
- On-going review of agreed outputs and adequacy of resources to meet increasing demands.

- Formalize the dialogue process with the Cabinet through a MOU with the Portfolio of Finance.

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Implementation of effective budgeting process with Government through annual Ownership and Purchase Agreements	Implemented
Implementation of regular meetings with the Financial Secretary and Cabinet representatives	Ad hoc meetings held
Implementation of enhanced risk-based approach to supervision of licensee	Risk assessment of licensees exercise completed in Banking Division; ongoing in other supervisory divisions
Improvement of fee collection process	Ongoing
Implementation of time management system	Implemented
Implementation of enhanced Methodology for determination of staffing needs	Implemented
Actively pursue construction of CAT 5 building	Consultations ongoing with Government over CIMA facility requirements in planned Government office complex.
Complete Business Continuity Plan	Complete
Analyse possibility of fee charging for specific services/functions	Ongoing
Review and Upgrade of Information systems	In progress
Consideration of Electronic reporting system for audited accounts and prudential returns	E-reporting system for mutual funds adopted. To be implemented beginning with funds having a December 2006 year-end.

GOAL 3:

To preserve the value and integrity of the Cayman Islands' currency.

Objective 1:

- Maintain and safeguard adequate reserves.

Strategy

- On-going review of the Monetary Authority's investment strategy.

Tactic

- Periodic review of investment strategy
- Monitor adherence to the investment strategy and advise of any deviations.

Objective 2:

- Deter counterfeiting.

Strategy

- Educate and train Currency personnel and the general public.

Tactic

- Training of Currency personnel in fraud and counterfeiting detection to ensure they are kept abreast of the latest trends; continuation of relationship with

Commercial Crime Unit; education of the general public via website advisories, press releases and workshops.

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Research paper with analysis and recommendations regarding design and security features for currency	In progress in conjunction with paper on methodology for ordering new currency.
Research paper with analysis and recommendations regarding design of vaults and cash handling facilities	Being done in conjunction with planning of category-five hurricane rated facilities for CIMA.

Objective 3:

- Provide adequate stock and facilities for the physical safeguarding of the currency.

Strategy

- Advise the Cabinet on what constitutes appropriately secure facilities for the safeguarding of the currency.
- Ensure that the working environment is safe and conducive to an efficient operation.
- Ensure that stock levels are adequate to meet demand in all circumstances

Tactic

- Identify suitable accommodation.
- Identify and implement an appropriate electronic vault management system

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Research paper with analysis and recommendations regarding disaster recovery back up stocks	In progress in conjunction with paper on methodology for ordering new currency
Paper establishing proposal(s) for methodology of ordering new currency	In progress

GOAL 4:

To raise the profile in order to increase understanding of the Monetary Authority both locally and internationally.

Objective 1:

- Strengthen relations with regulatory counterparts, and all other stakeholders (the government, the industry and the public).

Strategy:

- Involvement in relevant international forums; coordination with local private sector organizations and Government bodies (e.g. the Secretariat) to address the regulatory aspects of the international initiatives.
- Establish an educational campaign to educate general public on role and responsibilities of the Monetary Authority; work with the Complaints Commissioner in ensuring that the Monetary Authority is cognizant of the opinions of the general public and how the Monetary Authority is perceived.

Tactics:

- Identify appropriate forums that add value to the regulatory process; ensure that relationships are forged with the Cabinet/private sector and that appropriate information is disseminated.
- Utilise the Monetary Authority's website to disseminate information.
- Publish regular features in local and international media to ensure the Monetary Authority maintains a high and positive profile locally and overseas.
- Participation of Senior Management Team in local and international conferences/workshops.
- Expand educational initiatives beyond local high school to other educational establishments both locally and overseas. Participate in careers fairs, information seminars, mentoring schemes.
- All Directors to take every opportunity to promote the work of CIMA, which would include speaking engagements and attending functions.

Projects on 2005-06 Non-routine Work Programme	Status at 30 June 2006
Implementation of enhanced website	Implemented. Further development in progress
Addition to website of FAQs that provide key guidance and assistance to prospective and existing investors and consumers regarding regulation and consumer protection.	In development
Publication of Procedure on Complaints Against the Authority	Completed
Expand publication of enforcement actions	Ongoing
Annual update and reissue of Regulatory Handbook	Completed
Continuation of regular meetings with industry associations	Ongoing
Implementation of regular meetings with industry leaders and Government	Ongoing

Objective 2:

- Forge/enhance relationships with local and international media

Strategy:

- Increase networking opportunities for Public Relations Executive, the Managing Director and other senior members of staff.

Tactic:

- Proactively disseminate information e.g. interviews and articles for leading journals and broadsheets.
- Ensure that the Monetary Authority's perspective is accurately conveyed, establish/continue regular briefing meetings with local press and local associations.

Status at 30 June 2006

Ongoing

Table 15: Routine Outputs and Special Projects – KEY PERFORMANCE INDICATORS

Key Performance Indicators	Banking		Fiduciary		Insurance		Investment & Securities		Legal & Compliance		Policy & Development		Currency	
	2004/05 actual (target)	2005/06 actual (target)	2004/05 actual (target)	2005/06 actual (target)	2004/05 actual (target)	2005/06 actual (target)	2004/05 actual (target)	2005/06 actual (target)	2004/05 actual (target)	2005/06 actual (target)	2004/05 actual (target)	2005/06 actual (target)	2004/05 actual (target)	2005/06 actual (target)
Onsite Inspections	18 (20)	10 (20)	4 (15)	3 (10)	0*	27 (tbc**)	0^	10 (0^^)	N/A	N/A	N/A	N/A	N/A	N/A
Prudential Visits	289 (200)	160 (200)	22 (26)	79 (60)	323 (500)	376 (500)	0^	32(0^^)	N/A	N/A	N/A	N/A	N/A	N/A
Licences Issued; registrations	10 (6)	6 (6)	9 (12)	12 (12)	66 (60)	83 (70)	1520 (1475)	1807 (1520)	N/A	N/A	N/A	N/A	N/A	N/A
Destruction Meetings	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	51	74 (40)
Issue/Redemption of Currency	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	55	54 (58)
Enforcement Actions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	9	13 (15)	N/A	N/A	N/A	N/A
Litigation Cases	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4	8 (6)	N/A	N/A	N/A	N/A
Overseas Regulatory Assistance	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	107	107 (113)	N/A	N/A	N/A	N/A
Special Projects	4 (22)	30 (39)	1 of 10	15 (20)	0 (5)	15 (15)	5 (17)	20# (35)	8	6 (9)	7 (19)	16 (37)	N/A	3 (6)

Notes:

The 2004/05 figures represented above are as 22 June 2005

N/A The relevant department does not perform the indicated function

* Due to hurricane Ivan and the resources needed to tend to the needs of the domestic market, the onsite inspection programme was suspended. However, focused inspections have been performed as necessary.

** A full inspection programme is expected to commence 4th quarter 2005

^ The programme was suspended in July 2003 due to shortage of staff. Prudential visits are scheduled as necessary

^^ Shortage of staff will not permit the re-commencement of the programme during the 2005/06 period

Significant resources were devoted to the e-reporting project. In addition, a number of tasks were deferred pending the legislation following the Mutual Funds Working Group recommendations.

Table 16 - FINANCIAL & PERSONNEL RESOURCES

	2004/05 Actual	2005/6 Actual
Licence Fees:		
Banking	21,401,205	19,991,399
Insurance	5,777,191	6,005,645
Investments (inc SIBL)	15,484,329	23,064,831
Fiduciary	4,409,423	4,962,448
Total Fees	47,072,148	54,024,324
	2004/05	2005/6
Income:		
Gov. Funding	9,272,062	12,495,240
Investment income	2,555,311	3,945,641
Commission income	610,993	812,504
Numismatic & Other	76,559	263,298
Total Income	12,514,925	17,516,683
Expenses:		
Salaries	6,504,063	7,485,212
General and Admin	2,256,707	2,188,863
Conf., Travel, Training	509,662	600,322
Prof. Fees	347,633	789,307
Rent and Depreciation	465,158	647,588
Total Expenses	10,083,223	11,711,292
Surplus:	2,431,702	5,805,391
Staff	94	103

Executing our functions...

**MONETARY
REGULATORY
COOPERATIVE &
ADVISORY**

MONETARY FUNCTIONS

CURRENCY MANAGEMENT

The Monetary Authority, through its Currency Operations Division, is the sole issuing authority for Cayman Islands currency. The division is responsible for the issue, re-issue, and withdrawal of Cayman Islands currency notes and coins against the United States dollar, dealing with the local retail banks: Fidelity Bank, FirstCaribbean International Bank, Butterfield Bank International (Cayman) Ltd., Cayman National Bank, Scotiabank, and the Royal Bank of Canada. The division also administers the sale and redemption of numismatic coins to and from local and overseas collectors.

Currency Reserve

Cayman Islands currency is issued on demand only against United States currency at the rate of one Cayman Islands dollar per 1.20 US dollars. It is repurchased on demand with US dollars at the same rate. The currency in circulation is backed by the currency reserve assets in accordance with section 32 of the Monetary Authority Law (2004 Revision) (MAL). The currency reserve assets are invested primarily in US treasury notes, US government agency issued discount notes and mortgage-backed securities through the Authority's external fund managers. The guidelines that the fund managers use in selecting investments are security of funds, liquidity of funds, and income, in that order.

At 30 June 2006, total currency reserve assets equalled \$90.9 million (unaudited) representing 129 percent of currency in circulation. By comparison, at 30 June 2005, total currency reserve assets stood at \$89.8 million (unaudited), 124 percent of currency in circulation.

Currency Stocks

During 2005-06, CIMA commissioned the re-mint of an additional eight million one-cent coins. This is in addition to the 10,220,000 pieces minted in early 2005. There is an ever-increasing need to issue new one-cent coins, as the public is not re-circulating them. The Authority is currently exploring options to encourage people to redeem their hoarded coins.

The newly reprinted \$100, \$25, \$10, \$5 and \$1 banknotes arrived during the year. These notes are part of the current "C" series family, with one of the differences being the change in signatories to the Financial Secretary, Hon. Kenneth Jefferson, and the Authority's Managing Director, Mrs. Cindy Scotland. These banknotes also have added features that make them more sturdy and counterfeit resistant.

In May the local banknote stock level was increased for general use and in preparation for the hurricane season beginning in June. The Authority made arrangements for a back-up stock to be stored overseas to ensure continuous supply in the event of unplanned destruction or depletion of local stocks.

Currency in Circulation

Fig. 9: Cayman Islands Currency in Circulation, by Month, 2002-06

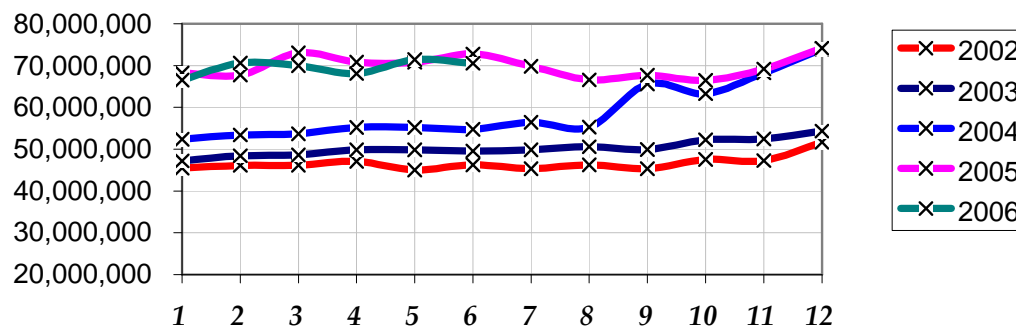


Table 17: Currency in Circulation at Fiscal and Calendar Year-end, 2002-06 (in CI\$m)

	2002	2003	2004	2005	2006
30 June	46.2	49.5	54.8	72.8	70.5
31 December	51.6	54.3	74	74.2	

At 30 June 2006 currency in circulation (excluding numismatic coins) totalled \$70.5 million, comprising \$62.7 million in notes and \$7.8 million in coins. This was a 3.2 percent decrease from \$72.8 million the year before. There is no immediate indication that currency in circulation will return to pre-Hurricane Ivan levels given the consequences of inflation and increased economic activities since Hurricane Ivan hit the Cayman Islands in 2004.

Total notes withdrawn from circulation and destroyed in the 2005-06 financial year was \$23.7 million compared to \$26.8 million in the previous year. During the reporting period the Currency Division completed its concentrated effort to clear the backlog of mutilated notes in stock.

REGULATORY FUNCTIONS

The framework for the Monetary Authority's regulation and supervision of financial services is made up of a number of elements. These include the applicable laws (as listed) and regulations passed by the Government of the Cayman Islands; rules and statements of principle and of guidance issued by the Authority; and policies and procedures detailed in the *Regulatory Handbook* and other manuals. Regulation and supervision are carried out in accordance with internationally accepted standards where these exist and are appropriate for the jurisdiction.

The Banking Supervision, Fiduciary Services, Insurance, and Investments and Securities divisions (collectively referred to as the supervisory divisions) are responsible for processing, and making recommendations on, applications for licences and other relevant authorizations for the provision of those financial services falling within their sectors. They are also responsible for the ongoing supervision of licensees/registrants, and make recommendations for enhancements to the supervisory regime where appropriate.

Supervision of licensees is carried out off-site and on-site. Off-site supervision is continuous, involving the analysis of quarterly prudential returns and annual audited statements, supplemented with prudential meetings. On-site supervision involves, 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.

Because of the nature of investments and securities business, the regulatory regime for this sector differs in some respects from the regulation of the other sectors. The regime is explained in more detail in the Investments and Securities Section, pages 40-42.

To further refine its risk-based approach to the supervision of licensees and increase effectiveness and efficiency in the deployment of supervisory resources, the regulatory divisions undertook a licensee risk assessment exercise during 2005-06. The exercise, which is still in progress in some divisions, involves the complete and detailed review of the files compiled by the Authority in respect of each entity and the subsequent application of a risk weighting to each, based on a methodology approved by the Authority's Board of Directors. Once completed, this will enable the divisions to focus resources on those entities perceived as a greater risk and to give some priority to regulatory intervention if necessary.

The supervisory activities of each of the four divisions and regulatory developments in each of their sectors are outlined in the following pages.

Table 18: Framework Under Which the Cayman Islands Monetary Authority Operates

Sector/ Entity type	CI Law	International Standards / Memberships
All	<ul style="list-style-type: none"> • Monetary Authority Law (2004 Revision) • Proceeds of Criminal Conduct Law (2005 Revision) • Money Laundering Regulations (2006 Revision) • Public Management and Finance Law (2005 Revision) • Companies Law (2004 Revision), and amendment 	<p>Standards:</p> <ul style="list-style-type: none"> • Financial Action Task Force Forty Recommendations on Money Laundering and Nine Special Recommendations on Terrorist Financing
Banks, trusts, money services businesses, credit unions, building societies, corporate services providers	<ul style="list-style-type: none"> • Banks and Trust Companies Law (2003 Revision), and amendment and regulations • Money Services Law (2003 Revision), and regulations • Cooperative Societies Law (2001 Revision), and regulations • Building Societies Law (2001 Revision) • Development Bank Law (2004 Revision) • Companies Management Law (2003 Revision), and regulations 	<p>Standards:</p> <ul style="list-style-type: none"> • Basel Core Principles for Effective Banking Supervision⁸ • OGBS Trust and Company Service Providers Working Group Statement of Best Practice produced by the of the Offshore Group of Banking Supervisors⁹ <p>Memberships:</p> <ul style="list-style-type: none"> • Offshore Group of Banking Supervisors (OGBS) • Caribbean Group of Banking Supervisors • Association of Supervisors of Banks of the Americas.
Insurance companies, managers, brokers, agents	<ul style="list-style-type: none"> • Insurance Law (2004 Revision) 	<p>Standards:</p> <ul style="list-style-type: none"> • International Association of Insurance Supervisors (IAIS) Core Principles of Insurance Regulation¹⁰ <p>Memberships:</p> <ul style="list-style-type: none"> • IAIS • Offshore Group of Insurance Supervisors¹¹
Mutual funds, fund administrators, securities investment businesses (market makers, broker-dealers, securities arrangers, securities advisors and securities managers)	<ul style="list-style-type: none"> • Mutual Funds Law (2003 Revision) • Securities Investment Business Law (2004 Revision) 	

⁸ As promulgated by the Basel Committee on Banking Supervision.

⁹ 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 locally accepted as appropriate guidelines for the proper conduct of trust and corporate business.

¹⁰ Issued by the International Association of Insurance Supervisors (www.iaisweb.org). The Cayman Islands is a charter member of this association.

¹¹ www.ogis.net

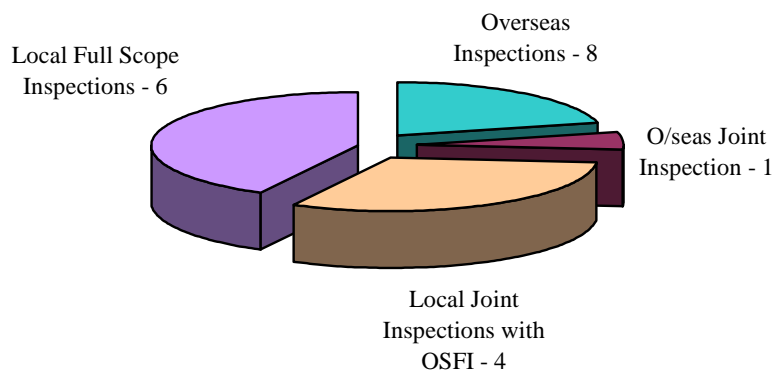
BANKING & RELATED SERVICES

Supervisory Activity

Inspections and Off-site Surveillance

During the 12-month period under review, the Banking Supervision Division conducted 160 prudential meetings and 19 on-site inspections. The breakdown of inspections is shown in figure 10. They included a joint overseas inspection with the Superintendencia de Banca y Seguros of Peru, and supervisory visits to banks operating from New York. The division also conducted joint inspections at banks on Grand Cayman with the Office of the Superintendent of Financial Institutions (OSFI) of Canada as part of OSFI's consolidated supervisory mandate.

Fig. 10: On-site Inspections of Banking Licensees, 2005-06



An analysis of the inspection findings indicated the following issues licensees needed to address: inadequate policies and procedures; insufficient customer due diligence documentation; lack of non-executive board members, and the need for more frequent board meetings. In general, most banks have completed the retrofitting of the due diligence information on clients and remain financially sound.

The 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

Rules and Statements of Guidance

During April of 2006, the Authority issued seven proposed rules for consultation, covering: Credit Risk Management; Country and Transfer Risk Management; Interest Rate Risk Management; Investment, Securities and Derivatives Risk Management; Liquidity Risk Management; Loan Loss Provision; Large Exposure and Credit Risk Concentration. It also issued for consultation a statement of guidance on and Large Exposures and Credit Risk Concentration.

These aimed to ensure that banks have appropriate systems and controls to manage risks identified by the rules and statement of guidance. This includes maintaining adequate liquidity; monitoring and controlling interest rate risk and credit exposures; ensuring there are adequate provisions to absorb losses; identifying and controlling large credit exposures - which might otherwise be a source of loss to a bank on a scale that might threaten its solvency. During the development of the measures, the Authority conducted an industry workshop to receive input and provide clarification on the proposals.

The following statements of guidance were issued after consultation and Cabinet approval:

Credit Risk Asset Classification for Banks - aimed at providing a more systematic assessment of banks' asset quality in order to improve banks' credit risk management and enhance the monitoring of banks' asset quality and adequacy of provisions.

Investments Securities and Derivatives Risk Management for Banks – aimed at setting sound risk-management practices relevant to most portfolio-management endeavours and providing guidance on the management of investments and end-user activities in banking entities.

The SOG: *Minimum Criteria for Maintaining Physical Presence*, was also drafted for banks subject to section 6(6) of the Banks and Trust Companies Law and was at pre-consultation stage at the end of the reporting period.

Basel II

The division continued preparing for, and increasing awareness of, the implementation of the New Capital Accord – Basel II in G-10 countries at the end of 2006. The tendering process for an assessment of the various Basel II options and their potential impact on Cayman's banking industry and on the Authority began in May 2006. The project was to facilitate the identification and selection of the best option for the Authority to implement. Discussions with local industry representatives to consider the implications of Basel II for the Cayman Islands continue.

Proposed Amendments to the Basel Core Principles

The Basel Committee is in the process of updating the Basel Core Principles for Effective Banking Supervision to align them more closely with developments in banking practice and supervision over time. The committee stated that it kept changes to the principles to a minimum to ensure their continued relevance as a flexible, globally applicable standard.¹² It noted that the focus remains on the necessary infrastructure for effective banking supervision and on ensuring efficient supervision of both advanced and less advanced banking systems.

The Authority provided comments on the proposed amendments through the regional and other groupings of which the Authority is a member (i.e. CGBS, OGBS and ASBA). Once the revised principles are implemented, the Authority will review them further to determine what changes are needed to Cayman's laws, regulations, rules, SOGs, etc., to ensure continued compliance. The Basel Committee was expected to adopt the amended Core Principles before the end of 2006.

¹² Bank for International Settlements' press release of 6th April 2006 "Basel Committee seeks comments on updated banking supervision principles"

FIDUCIARY SERVICES

Supervisory Activity

The Fiduciary Services Division conducted three on-site inspections during 2005-06 and 79 prudential and non-routine meetings with licensees.

The increase in the number of licensees reported earlier in this report meant an increase in the volume of ongoing monitoring activity. There was also an increase in the processing of applications for various change approvals from licensees. The division is unable to confirm whether these are necessarily indicative of a trend that will continue into the 2006/7 financial year. Records indicate that numerous groups made changes to their boards, in some instances due to consolidation at the parent level of the licensee. Group restructurings for some larger groups that affected multiple licensees are a partial explanation for increases in applications for shareholder and director approvals.

As at 30 June 2006, the division's risk-rating exercise was approximately 40 percent complete. The projected completion date for the exercise was revised to December 2006.

Regulatory Developments

The division undertook the review and revision of its existing on- and off-site manuals and biannual reporting form, and the documentation of the rationale for the restrictions imposed on restricted trust licences in regard to the volume of trusts that may be administered by the holder of that licence.

Typologies Project on the Misuse of Corporate Vehicles

Determining beneficial ownership of corporate vehicles, accessing and sharing this information across borders and developing a checklist to identify vulnerable jurisdictions were among issues discussed at the Financial Action Task Force/FATF of South America (GAFISUD) typologies workshop in November 2005 in Brazil. The exercise was in response to the perception that criminals have sought to use corporate vehicles and providers of trust and corporate services to assist in disguising the proceeds of crime for entry into the financial system. The Authority participated under the auspices of the Caribbean Financial Action Task Force.

A small core group of the persons that attended the typologies workshop in November, including representatives from the Authority, met in London in January 2006, to prepare the first draft of a report to the FATF on the conclusions of the project team. The draft report was circulated for comment. The final report was still in progress at the end of the fiscal year.

Private Trust Companies

During the last quarter of the fiscal year, the local chapter of the Society of Trust and Estate Practitioners made formal representations that the existing regime for the licensing and regulation of private trust companies might be dampening the growth of business in Cayman's private wealth management arena. Subsequent to the end of the reporting period, the Chairman of the Board held a roundtable discussion on the issue

with relevant industry members and the Authority has added a review of the trusts regime to its non-routine work programme for 2006-07.

Working Groups

Fees – A working group was set up to examine the licence fee structure for company managers and trust companies to determine any disparity and report any corrective recommendations to the Cabinet. This followed concern from representatives of the company management industry over differences in the annual licensing fees for the two types of entities. Having considered the working group's input, the Authority was preparing a report to the Cabinet at the end of the fiscal year.

Unregulated and Exempt Entities - A working group was assembled in 2005 to review the appropriateness of the regime for unregulated and exempted entities and the regulation of corporate services. The group held two formal meetings during the year and requested clarification from the Financial Secretary on the scope of its work. As at the end of the reporting period, the group was awaiting direction from the Government in order to reconvene.

Restricted Trust Company Fees

Increases in the annual licence fee and licence application fee for restricted trust companies were set to take effect on 1 July 2006. The annual fee has been increased by the Government from CI\$6,000 to CI\$7,000 while the licence application fee has been raised from CI\$1,000 to CI\$2,000. However, the increases will be immaterial unless a licence application is declined, as application fees are refunded to the licensee upon grant of a restricted trust licence, pursuant to the Banks and Trust Companies Law (2003 Revision).

Statements of Guidance

The following SOG was finalized and brought into effect:

1. *Licensing of Unrestricted, Restricted and Nominee Trust Companies* - Issued on 18 April 2006, this provides direction to industry on trust company licensing.

The following were issued for industry consultation:

1. *Internal Controls for Trust Companies, Company Managers, and Corporate Services Providers* - This provides guidance on the requirement imposed on licensees by the Rule on Internal Control, and a standard of best practice to licensees for the implementation of an effective and sound internal control system.
2. *Internal Audit for Unrestricted Trust Companies* - This provides guidance on internal audit functions (as called for in section 3.6 of the Statement of Guidance on Corporate Governance) and provides a standard of best practice to licensed trust companies for the implementation of an effective and sound internal audit function.

The following pre-consultation draft SOGs were prepared:

1. *Establishment or Acquisition of Branches, Subsidiaries or Representative Offices – Trust Companies, Company Managers, and Corporate Services Providers.*
2. *Revocation of Licence Surrendered for Cancellation – Company Managers and Corporate Services Providers.*

INSURANCE

Supervisory Activity

Inspections

The Insurance Supervision Division completed a series of special on-site inspections during the fiscal year. These were aimed specifically at ensuring that insurance entities are aware of their responsibilities under the Cayman Islands anti-money laundering regime, principally the Proceeds of Criminal Conduct Law (2004 Revision) and regulations issued there under, and the Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands.

Prudential Meetings and Off-site Supervision

Regular meetings were held with insurance managers, representatives of the boards of captive insurance companies and with representative of the brokers and domestic insurers to discuss the operation of the companies and issues affecting the insurance market. Regular meetings were also held with the Insurance Managers Association, the Life Underwriters Association and the Cayman Islands Insurance Association to discuss market issues.

Regulatory Developments

Insurance Law Review Working Group - The working group formed in 2004 to review the insurance law and regulations submitted its report to the Government in June 2006. Public consultation to solicit final comments subsequently began. The Authority anticipated changes to the insurance law, and accompanying regulations and statements of guidance, by the last quarter of 2006.

One significant change expected was the introduction and upgrading of legislation and regulations to accommodate open market reinsurance companies, as Cayman continues its efforts to attract these companies to enhance the Island's reputation as a one-stop insurance market.

Recommendations for enhanced protection of domestic policyholders included: making contracts by unlicensed insurers enforceable; making brokers that place business with unlicensed insurers personally liable in the event of failure of that insurer to settle a claim; requiring market conduct standards to ensure that insurers accept responsibility for their agents and to prevent false or misleading advertising; and setting more precise provisions for 'ring fencing' of approved external insurers' assets to ensure funds are available to meet their local liabilities.

Brokers Code of Conduct – The Cayman Islands Insurance Association (CIIA) produced a Code of Conduct for Brokers, with input from the Authority. The association expected to formally adopt the code once the CIIA was constituted by the Governor of the Cayman Islands.

OGIS - The Head of Insurance was re-elected to the post of Secretary of the Offshore Group of Insurance Supervisors at the OGIS meeting in October.

Statements of Guidance

The following SOGs were issued for consultation:

1. *Capital Adequacy for Class B Insurers* - This provides guidance on the Authority's approach to capital and solvency requirements and raises compliance with international standards.
2. *Market Conduct Class A Insurers and Agents* - This revised SOG provides guidance on the standards of market conduct expected of insurers and agents operating in the domestic market and thus add transparency to the Authority's approach to monitoring and exercise of its powers under section 12 of the Insurance Law (2004 Revision), namely to issue directions to licensees, when they are committing, about to commit, pursuing or about to pursue a course of conduct that is an unsafe or unsound practice in conducting the business of the licensee.

The following pre-consultation draft was prepared:

1. *Revised Sector Specific Guidance for Insurance for the Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands.*

INVESTMENTS & SECURITIES

Cayman Islands Mutual Funds and Securities Investment Business Regime

Although Cayman Islands legislation refers to “mutual funds,” the vast majority of the funds registered in this jurisdiction fall within the loose definition of a “hedge fund.” The regulatory oversight of hedge funds varies considerably around the world with many jurisdictions only recently enacting legislation.

Licensed Fund

Generally, funds licensed under section 4(1)(a) of the Mutual Funds Law (MFL) are more closely associated with retail mutual funds. In considering a licence application, the Authority evaluates the fund promoter’s reputation, the administrator’s expertise, fitness and propriety, and whether the fund’s business will be carried out properly.

Administered Fund

For a fund to be authorised as an administered fund under section 4(1)(b) of the MFL, a CIMA licensed administrator (i.e.: the directors and managers of which have sufficient expertise to administer regulated funds and have been approved as fit and proper persons by the Authority) provides the Principal Office and ensures that the fund is run in a fit and proper manner.

Registered Fund

For a fund to be authorised under section 4(3)(a)(ii) of the MFL, it must either have a US\$50,000 minimum subscription or have its equity interest listed on a recognised stock exchange. The stock exchange (through its listing rules, for example) provides a form of enhanced supervision. This type of fund is considered a registered fund for statistical purposes. The minimum investment will be increased to US\$100,000 once the Mutual Fund (Amendment) Bill is passed. (See Regulatory Developments – Mutual Funds Working Group later in this chapter.)

Because of the statutory minimum subscription for funds registered under MFL section 4(3)(a)(i), the investor is considered to be sufficiently sophisticated or experienced in investing that it will perform its own due diligence and does not need any regulator to do so. In practice, the great majority of investors are professional investors and institutions. Most of these funds have a US\$1 million minimum subscription level, and they are usually distributed as a private placement, all of which further reinforce the non-public nature of these funds.

Unlike some jurisdictions, the Cayman Islands does not require a declaration or test to determine if an investor should be considered professional or sufficiently sophisticated; the minimum subscription is the only determinant that the fund fits this category.

Difference in Approach for Licensed and Non-Licensed Regulated Funds

While the Authority conducts due diligence prior to licensing a fund, it does not perform such due diligence to register non-licensed regulated funds. The regulatory approach for these funds is “lighter” because for each category of non-licensed regulated fund, there is an additional measure of indirect supervision: either another

party provides oversight, or the investor is considered to be sophisticated and capable of performing its own due diligence.

The overriding regulatory objective for non-licensed regulated funds is to compel full and proper disclosure by fund operators so that investors are not misled about the nature of the risk taken. The objective is achieved chiefly by requiring these funds to prepare and file offering documents describing the equity interests in all material aspects such that a prospective investor may make an informed decision about subscribing without relying on the Authority. The principle of “buyer beware” is paramount, since it is the investor, and not the Authority, that is responsible for its own due diligence on a fund’s service providers, promoters, operators, strategy, risk-profile, track record, etc.

The MFL section 4(8) further provides that a current offering document (or its prescribed details) is not considered to be filed with the Authority if the operator or promoter is aware of any change that materially affects any of the information contained in the offering document and if such amendments have not been filed with the Authority within 21 days.

Mutual Fund Administrator

In addition to authorising mutual funds, the Authority handles licence applications for mutual fund administrators and regulates their activities. Two categories of licences are issued: full administrators and restricted administrators.

Securities Investment Business

Under the Securities Investment Business Law (2004 Revision) (SIBL) a person who carries on securities investment business in any one or more of the activities set out in Schedule 2 is required to obtain a licence unless exempt from doing so.

Supervisory Activity

Inspections

Beginning in late 2005, the Investments and Securities Division (ISD) conducted ten inspections under its risk-based limited-scope inspection program and made a number of recommendations to enhance industry “best practice” and policy & procedures relating to fund administration.

Prudential Meetings and Off-site Supervision

The division held several consultation meetings with industry regarding electronic filing of audited accounts under the proposed electronic reporting system for the division. (See the “Regulatory Developments” section below). Staff also liaised with directors, registered offices and local auditors to verify information held by the Authority, as part of the CIISMA “clean up project” in preparation for e-reporting.

SIBL licensees have now submitted four quarterly returns, pursuant to the Securities Investment Business (Financial Requirements and Standards) Regulations, 2003, after the division first requested financial reports for the quarter ending 31 March 2005. As this was the first year of reporting, ISD worked with all licensees to ensure consistent application of the regulations. The division will use the information to assist with its licensee risk assessment and to prioritize inspections in the new financial year.

Regulatory Developments

Mutual Funds Working Group

Discussions between the Authority and the Financial Secretary's Office during 2006 revealed little divergence between the Government's views the Mutual Funds Working Group's recommendations, which were submitted to the Financial Secretary in August 2004. The main difference was Government's preference that some of the recommendations be implemented as rules or statements of guidance rather than as legislation. Although the proposed legislative changes were not yet passed at 30 June, it was expected that the Government would approve the Mutual Funds Bill by the end of the calendar year.

Electronic Reporting (E-Reporting) System

ISD, the Policy and Development Division and the Information Systems Unit spent significant resources developing the e-reporting system for all entities regulated under the Mutual Funds Law. The system will enable electronic filing of key data and audited accounts and the Authority will expand it to other divisions over time.

During the year, consultants Ernst & Young were appointed to assist in the project's development; the Authority issued a project consultation paper and held extensive discussions with industry, and an information technology systems consultant was selected to provide and implement the technology. Implementation should be completed by the first quarter, 2007.

Global Scrutiny of Hedge Fund Regulation

Many regulators in major financial centres have expressed concern over risks associated with hedge funds. With the Cayman Islands having provided a regulatory and legal framework for such funds since 1993, CIMA is confident that its regulatory philosophy for both non-public and public funds is appropriate. The Authority is thus pleased that more regulators are reaching a better understanding of the operation of hedge funds and their contribution to financial systems.¹³ The Authority is committed to improving global understanding of the hedge fund industry and participates in a number of initiatives with this objective.

¹³ See for example, UK Financial Services Authority's feedback paper, *Hedge Funds: A Discussion of Risk and Regulatory Engagement*, March 2006: http://www.fsa.gov.uk/pubs/discussion/fs06_02.pdf , and Remarks of Treasury Assistant Secretary for Financial Institutions Emil Henry to the Federal Reserve Bank of Atlanta, 18 April 2006: <http://www.ustreas.gov/press/releases/js4187.htm> .

GUIDANCE, COMPLIANCE & ENFORCEMENT

Policies, Guidelines and Rules

The development, documentation and issuing of guidance for the financial industry is spearheaded by the Policy and Development Division. The division is responsible for researching industry and regulatory topics, for drafting policy and for co-ordinating the development of instruments applicable to, and for the benefit of, financial services providers. It works in conjunction with the supervisory divisions, the Compliance Division and in consultation with industry.

Rules and statements of guidance developed specifically for the banking, insurance and fiduciary sectors during 2005-06 have been listed in the foregoing chapters. The Policy and Development Division also drafted one general rule applicable to all licensees: *Rule on Internal Controls*. This instrument requires licensees 'to establish and maintain such systems as are appropriate to their business.'¹⁴ At 30 June the draft was out for private sector consultation.

The Authority issued the *Regulatory Handbook - Volume 1*¹⁵ in March 2006. This volume replaced the *Interim Regulatory Handbook* and consolidates procedures and policies implemented since the issuing of the interim publication in 2003.

During 2005-06, amendments to the sector specific guidance dealing with insurance in the *Guidance Notes for the Prevention and Detection of Money Laundering (GN)*¹⁶ were started. These amendments are in accordance with the IMF's recommendations. The Authority and financial sector associations produced the GN as a set of guidelines for financial services providers to protect the sector from money laundering. The Guidance Notes Committee, comprising representatives from the Authority, the financial industry and the Government, reviews and updates the GN.

Due Diligence and Enforcement

As part of its regulatory functions, the Authority conducts due diligence on persons who have applied to act as directors, shareholders, managers, officers and controllers of licensed entities; investigates serious breaches of the regulations and, where necessary, takes enforcement action.

¹⁴ From the document: Private Sector Consultation in Relation to a Proposed Measure: Proposed Rule on Internal Controls – General for all Licensees. On the CIMA website under Regulatory Framework/Policy and Development/Consultation:
http://www.cimoney.com.ky/uploadedFiles/Regulatory_Framework/Regulatory_Handbook/PSCP-Rule-InternalControlsGeneral.pdf

¹⁵ On the CIMA website under Regulatory Framework/ Regulatory Handbook:

<http://www.cimoney.com.ky/section/regulatoryframework/sub/default.aspx?section=PD&id=71>

¹⁶ On the CIMA website under Regulatory Framework/ Anti-money Laundering / Guidance Notes:
<http://www.cimoney.com.ky/section/regulatoryframework/sub/default.aspx?section=AML&id=242>

Due Diligence

The Authority's *Guidelines - Fitness and Propriety*¹⁷ sets out the criteria for determining whether persons are fit and proper to act as directors, shareholders, managers, officers and controllers of licensed entities. In making this determination, the Compliance Division is tasked with researching and conducting due diligence on applicants as referred to it by the regulatory divisions.

The nature and scope of the work performed by the Compliance Division is dependent on the risk assessment made on each application and may include independent verification of the documentation submitted, review of public information and other steps. The *Procedure – Assessing Fitness and Propriety*¹⁸ sets out the procedure for assessing the fitness and propriety of persons applying to act as (or are existing) directors, operators, senior officers, general partners, promoters, insurance managers or shareholders of licensed entities.

The Compliance Division reports its findings to the supervisory divisions, which then make the final decision as to applicants' fitness and propriety.

Table 19: Due Diligence Applications Referred to the Compliance Division, 2005-06

	Division Referring				
	Banking	Fiduciary	Insurance	Investments	Total
Applications as at 30 June 2005:	33	87	2	41	163
Applications as at 30 June 2006:	38	137	5	34	214

Enforcement

The Authority's *Enforcement Manual*¹⁹ describes the policies and procedures for the exercise of its enforcement powers in the event of non-compliance with the regulatory laws. The manual sets out the range of tools available to the Authority 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 Authority has developed a ladder of compliance, issued as part of the *Enforcement Manual*, detailing the steps it will follow in the event of non-compliance by a licensee or registrant. Where appropriate, CIMA will

¹⁷ Available online at:

http://www.cimoney.com.ky/uploadedFiles/Regulatory_Framework/Policy_and_Development/Policies_and_Guidelines_and_Procedures/General/GuidelinesFitnessAndPropriety.pdf

¹⁸ Available online at:

http://www.cimoney.com.ky/uploadedFiles/Regulatory_Framework/Policy_and_Development/Regulatory_Handbook/RH_Appendices%20I%20%2015Mar2006%20EC%20.pdf

¹⁹ Available online at:

http://www.cimoney.com.ky/uploadedFiles/Regulatory_Framework/Policy_and_Development/Regulatory_Handbook/EnforcementManualJune%2006.pdf

work with the licensee or registrant in an attempt to resolve regulatory issues prior to the exercise of enforcement action.

In investigating serious breaches of the regulations, the Compliance Division collects pertinent information and documentation, and recommends disciplinary actions, if appropriate. All enforcement actions are in conformance with the powers provided under the respective regulatory laws and the Authority ensures the fair treatment of those who are subject to the exercise of its powers. The Authority took 13 formal enforcement actions during 2005-06 (12 for the Insurance Division, one for Investments and Securities), compared to nine formal enforcement actions for the previous financial year.

Litigation

The Legal Division leads enforcement and cooperative action involving litigation. During the 2005-06 fiscal year, the division conducted several litigation matters (see Table 20). Among cases presented to the court, five were winding up petitions and one was the seeking of directions from the court on the disbursement of funds held by the Authority in respect of Dyoll Insurance Company. Another matter involved the examination of persons as part of providing assistance to an overseas regulatory authority (see next chapter). The Compliance Division provided assistance on some of these cases.

Table 20: Litigation Conducted by the Legal Division, 2005-06

Winding Up Petitions	PFA Assurance Group Ltd. - Provisional Liquidation PFA Assurance Group Ltd. - Official Liquidation Employers Equity Insurance Company - Official Liquidation MTU Ltd. - Official Liquidation S & S Insurance Partners, Ltd. - Official Liquidation
Directions	Dyoll Insurance Co. Ltd.
Other	Examination pursuant to an overseas request for assistance

COOPERATIVE & ADVISORY FUNCTIONS

CROSS-BORDER COOPERATION

The Monetary Authority Law (2004 Revision) (MAL) lists the provision of assistance to overseas regulatory authorities as one of the principal functions of the Authority. Such international cooperation takes place through the exchange of information, as provided for in the MAL and facilitated through memoranda of understanding, as well as through the Authority's active participation in international fora (see "Role and Functions of the Monetary Authority," Appendix 1).

Memoranda of Understanding

From 1 July 2005 to 30 June 2006, the Legal Division drafted and negotiated, on the Authority's behalf, bilateral MOUs with the Office of the Superintendent of Financial Institutions – Canada, and Banco Central Do Brazil. It also entered into an undertaking for the sharing of information with the US Commodity Futures Trading Commission (CFTC), Washington D.C.

An MOU with the Jersey Financial Services Commission was awaiting Cabinet approval at 30 June. Discussions on MOUs with the Dubai Financial Services Commission and the Italian securities regulator, CONSOB, were ongoing at the time of this report. Negotiations were also in progress with the Office of Insurance Commissioner, Washington State, USA.

Assistance to Overseas Regulatory Authorities

An ongoing activity for the Legal Division is advising on, and co-ordinating responses to, requests for assistance from overseas regulatory authorities (ORAs). The division works closely with other CIMA divisions to ensure that requests are handled in a timely and efficient manner and that they conform to the requirements of the MAL. The *Procedure - Dealing with Requests for Assistance from an Overseas Regulatory Authority (ORA)*²⁰ sets out the Authority's approach in dealing with these requests. The process includes reviewing and assessing the requests and drafting directions to persons who have information that will assist the ORA in performing its functions.

The Authority received and processed 107 requests for assistance from ORAs, up from 101 during the previous financial year. Twelve of these were non-routine, i.e.,

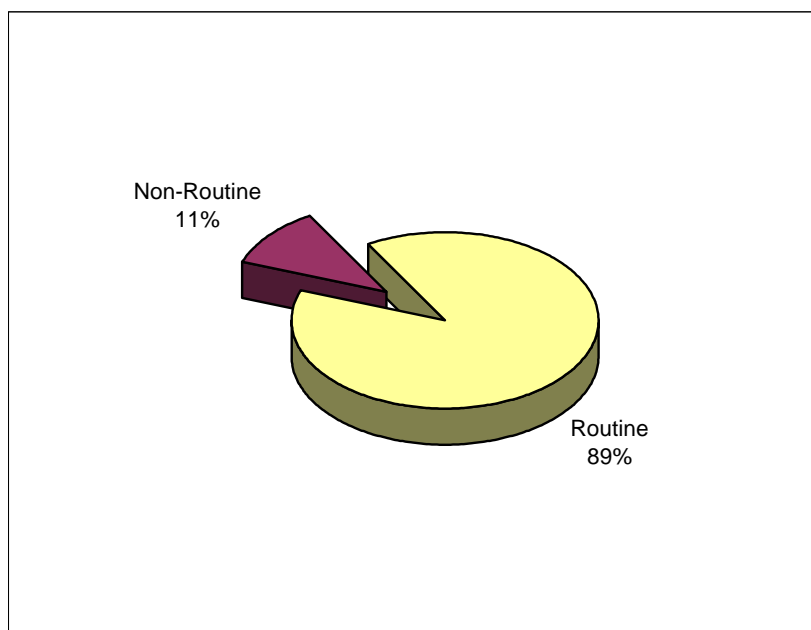
²⁰ On the CIMA website:

http://www.cimoney.com.ky/pages/aboutus/RHA_Revised_ORA_Procedures.pdf

not in relation to the carrying out of the requesting authority's day-to-day functions of approval of licences or approval of persons subject to regulation and registration of applicants.

The Compliance Division's mandate includes assisting the Legal Division in processing non-routine ORA requests in accordance the MAL. During the reporting period, the Compliance Division assisted on 10 of the overseas regulatory requests (including nine of the non-routine ones) from six ORAs. This compares to 11 handled by Compliance during 2004-05. In one instance, the provision of assistance involved the conduct of examinations of several persons before a magistrate. These examinations were the first conducted under section 34(11) of the MAL. The ORA expressed satisfaction at the level of assistance provided by the Authority on this matter.

Fig. 11: Proportion of Routine to Non-routine Overseas Regulatory Authority Requests for Assistance, 2005-06



International Initiatives

Information relating to the new Basel II Capital Accord, the Basel Core Principles revision revision, and the FATF typologies project on the misuse of corporate vehicles has been included with in the Regulatory Functions section of this report. Other notable initiatives in which the Authority was involved during 2005-06 are summarized below.

IOSCO - The Authority continued to engage in discussions with the International Organization of Securities Commissions regarding its application for membership in that body.

Equivalency of Anti-money Laundering Frameworks – In March, the Authority's General Counsel delivered a paper and presentation to the Offshore Group of Banking

Supervisors on the need for recognition of countries with equivalent anti money laundering frameworks. Coming out of the meeting, members agreed to the creation of a framework for the development of criteria to be used in the assessment or listing of other member jurisdictions.

International Assessments of the Cayman Islands - The Authority began arrangements, in conjunction with the Portfolio of Finance and Economics, for follow up review visits by the IMF and Caribbean Financial Action Task Force (CFATF). These will take place in 2007.

IMF Information Framework - In August 2005 the Authority advised the IMF of its participation in the Information Framework for International and Offshore Activities. The framework was developed to aid jurisdictions' information dissemination efforts, and to enable a broader view of developments in the global financial system. Annual data for 2004, covering banking, insurance, fiduciary and investments, was sent to the IMF in October 2005. Additional activity indicators for investments will be provided in the future once the electronic reporting system is implemented.

LOCAL COOPERATION

Money Laundering Reporting

The Head of Compliance is the Monetary Authority's Money Laundering Reporting Officer (MLRO) under the Proceeds of Criminal Conduct Law (2001 Revision). Any suspicion of money laundering identified by CIMA's staff in conducting their supervisory activities is reported to the MLRO, who has the responsibility to report to the Financial Reporting Authority (FRA) in conformance with the Money Laundering Regulations (2003 Revision). During the reporting period the MLRO filed six suspicious activity reports (SARs) with the FRA, compared to 17 during 2004-05.

Local Memoranda of Understanding

The Authority has an MOU in place with the Financial Reporting Authority. Draft protocols with the Cayman Islands Society of Professional Accountants (CISPA), the Health Insurance Commission (HIC) and the Financial Services Council were prepared and sent to those bodies for comment. They were still in review at 30 June.

ADVISORY ACTIVITY

The Monetary Authority Law (2004 Revision) requires CIMA to advise the Government on monetary, regulatory and cooperative matters, and to consult with the local private sector on proposed measures. Consultation on measures relating to specific sectors is covered in the 'Regulatory Functions' section of this report. Information on the CIMA-industry joint working groups dealing with company management and trust fees, unregulated entities, the Insurance Law review, and mutual funds is also given in the 'Regulatory Functions' section.

*Operational support &
Administration...*

**HR MANAGEMENT & DEVELOPMENT
INFORMATION SYSTEMS
PUBLIC RELATIONS
FINANCIAL CONTROL**

HUMAN RESOURCE MANAGEMENT & DEVELOPMENT

Staffing and Recruitment

The Authority's staff complement at 30 June 2006 was 104, or 22 below the budgeted complement of 126. Staff turnover for the year was 16 percent, average length of service being approximately eight years for senior management, three years for professional and technical staff and four years for clerical staff.

Table 21: Staff numbers by division at 30 June 2006

Division	Actual staff numbers at 30 June 2006	Approved staff numbers as per 2005-06 budget
Banking	14	21
Compliance	8	9
Currency Operations	5	7
Fiduciary Services	6	8
Insurance	12	16
Investments and Securities	21	24
Legal	5	6
Managing Director's Office	4	5
Operations (Accounts, Information Systems & Human Resources)	22	23
Policy & Development	7	7
TOTAL	104	126

Turnover was particularly noticeable at the analyst level, as many of the Authority's technically qualified and experienced analysts accepted better paying positions in the private sector. Replacing staff lost through resignations negatively affected the Authority's ability to meet its staff growth projections. The seemingly short supply of applicants of the desired quality and calibre also made recruitment difficult. However, the year ended with total new hires (34) being above resignations (21).

CIMA continued to support local career development initiatives and to expand awareness of its operations by accepting a number of students involved in internship and work experience programmes from the high schools and University College of the Cayman Islands and, in addition, employed a record 10 high school and tertiary students as part of its own summer internship programme.

Salary Re-balancing Exercise

Addressing one of the issues contributing to retention/recruitment difficulties, the Board of Directors mandated a salary re-balancing exercise. The project, which the Human Resources Unit coordinated and local firm Ernst and Young executed, aimed to identify and address anomalies in remuneration between CIMA and the marketplace. The exercise resulted in new salary scales being approved and adopted by the Board at the beginning of the 2006-07 financial year. It was anticipated that the scales would be competitive enough to enable the Authority to retain existing staff members as well as to attract skilled and qualified persons to vacant posts.

In conjunction with this exercise, the Board decided to discontinue annual cost of living salary adjustments and, instead, to perform regular salary reviews to keep employees' pay on par with market rates for similar qualifications, experience, etc.

Employee Appraisal and Advancement

In June, all employees received their annual formal performance appraisal. CIMA's current employee appraisal process, introduced in 2004-05, aims to ensure ongoing dialogue between managers/supervisors and their team members about performance and development. It provides a structure within which expectations are clear, the approach to performance assessment is consistent, and employees participate in identifying their training and development needs. The system facilitates the identification of employees for upward mobility when opportunities arise for which the individual is deemed ready. During 2005-06, 14 employees were promoted.

Table 22: Promotions, July 2005 through June 2006

Employee	Post to which promoted
Patrick Bodden	Deputy Managing Director
Malcolm Eden	Head of Banking
Rohan Bromfield	Acting Head of Fiduciary Services
Leticia Frederick	Chief Analyst, Fiduciary Services
Dena Thompson	Chief Analyst, Insurance
Christopher Bryan	Senior Analyst, Banking
Ryan Bahadur	Senior Analyst, Banking
Joelee Powell	Senior Analyst, Compliance
Jennifer Hydes	Senior Analyst, Fiduciary Services
Colleen Artuch	Senior Analyst, Insurance
Isatou Sey	Senior Analyst, Investments and Securities
Frederick Wilks	Senior Policy and Development Officer
Tara Campbell	Executive Secretary to the Board of Directors
Merlena McLaughlin	Junior Analyst, Banking

Training and Professional Development

Training events for 2005-06, and conferences that included training session, are listed in Table 23, with number of sessions attended by members within each division.

In-house Training

In-house training consumed much of the total training time, with most of the material being developed within the Authority. Opportunities were provided for every employee to participate in cross-divisional sessions, allowing staff to share information on divisional procedures and best practices. Included was a six-part staff orientation programme; and sessions on business-writing skills, understanding CIMA's appraisal process, conducting meetings and presentations, using computer applications and the new time tracking and website content management systems. There were also sessions on industry developments such as Basel II.

Managers and senior managers attended a two-day leadership retreat to focus on identifying and enhancing the core competences for effective leadership. Participants recommended a follow-up session to develop strategies to further strengthen the organization's effectiveness.

Among in-house training initiatives introduced in 2005-06 was the Pre-Orientation Programme (POP) for new staff. POP is a power-point presentation, e-mailed to the employee on his/her first day at work. It provides a quick introduction to the Authority and other pertinent information before the formal orientation.

Table 23: Training Events, 2005-2006

DIVISION	TRAINING EVENT					CONFERENCES	
	Overseas	Local	In-house	Webinars	Degree programmes	Overseas	Local
Banking Supervision	15	11	32	10	1	3	2
Compliance	0	11	18	1	1	5	1
Currency	2	3	11	2	0	2	0
Fiduciary Supervision		4	26	5	0	7	4
Insurance Supervision	5	11	22	4	1	8	
Investment & Securities Supervision	2	17	30	4	1	10	3
Legal	1	9	17	9	0	3	2
Managing Director's Office	0	3	15	2	0	2	2
Operations - Accounts	0	9	20	5	0	1	0
Operations - Human Resources	5	8	25	13	1	4	0
Operations - Information Systems	2	7	21	2	1	2	2
Policy & Development	2	5	19	11	2	4	2

Anti-money Laundering Training

The focus on anti-money laundering training continued. Six officers attended the 11th Annual Anti-Money Laundering Conference in Florida, while 14 registered for the Association of Certified Anti-Money Laundering Specialists (ACAMS) programme and participated in preparatory seminars. Most sat and passed the exam subsequent to the reporting period. Staff also participated in 'Too Hot to Handle' and other AML webinar series. These seminars delivered via the internet and conference call have proven to be a cost-effective, popular way for staff to learn from industry experts.

Future Training & Development

Discussions started on the upgrading of Training Manager, the software used for training logistics; the redesigning and expansion of the Authority's Intranet site; and on raising staff performance using the Human Performance Improvement (HPI) method. HPI is a systematic process for identifying and analyzing performance gaps, planning for performance development, designing and implementing interventions, and evaluating results. The Training & Development Specialist will work in partnership with Heads of Division to find the best solution to improving staff performance.

Accommodation

The Operations Division arranged the leasing and outfitting of additional office space in Elizabethan Square Phase 3 to house the Information Systems Unit, the Policy and Development, Insurance, and Compliance divisions, and a new Chairman's Office.

INFORMATION SYSTEMS

The Information Systems (IS) Unit undertakes the maintenance of the Authority's existing information systems and the review and planning of new implementations and developments. Major projects involving IS in 2005-06 are outlined below.

Time Tracking System

The Unit, working with the Accounts Unit and the Training and Development Specialist completed the implementation of a time tracking system, *TimeClock Plus*, during the reporting period. Most employees were trained on, and began using, the system by 30 June. The training programme, developed in-house, will be delivered to new staff as needed. The Accounts Unit has operational management of the system.

CIISMA Redevelopment

The unit continued the redesign and redevelopment of the Authority's enterprise information management system (CIISMA) that it had begun in the previous financial year. During 2005-06, the unit progressed the redesign of the fee receipting and mail registry modules, which are scheduled for deployment by the October-December quarter 2006. The fee-receipting module will provide the foundation for redevelopment of all other existing modules of CIISMA, current projections call for completion of all redevelopment work by fourth quarter 2007.

Electronic Reporting

The IS Unit worked with the Investments and Securities Division (ISD) and the Policy and Development Division to identify a vendor to develop online data returning systems for ISD's requirements. It is intended that this system will eventually replace the existing e-reporting system used by other divisions.

Business Recovery Plan

The unit was tasked with developing the Information Technology & Telephony Business Recovery Plan to provide for the resilience of the Authority's existing technology infrastructure and the implementation of recovery systems at a designated recovery centre. IS completed the fit-out of CIMA's primary recovery site. Facilities are in place to support the crisis management team and each division's business recovery team, with full access to network applications and telecommunication systems. The setup of the off-island recovery site on Cayman Brac was continuing at the end of the reporting period.

Website Upgrade

The unit undertook the CIMA website redesign and technical redevelopment (see 'Public Relations' below).

PUBLIC RELATIONS

The Monetary Authority endeavours to maintain and enhance relationships with its stakeholders and other groups through ongoing provision of information and through dialogue, consultation and collaboration as appropriate. Public relations activities are co-ordinated through the Managing Director's Office by the Public Relations Executive.

Website

A major priority mandated by the Board was the upgrade of the Authority's website. This was executed as a joint project of the Information Systems Unit, the Public Relations Executive, divisional representatives and the Training and Development Specialist. It involved the introduction of a content management system (Ektron CMS400) and complete site redesign. The new system allowed responsibility for the maintenance and creation of content to be fully returned to divisional representatives. The site went 'live' to the public on 24 February after several months' work on development and data migration from the old website and the planning and delivery of end-user training

Further development has been ongoing. Work has also continued on resolving certain technical issues related to the content management system which supports the website. At the end of the fiscal year, a strategic framework for the development of the site was being drafted and the responsibilities and procedures for the running of the site were being documented. Preparations were also in train for the hiring of external assistance for the reassessment and further refinement of the site.

Publications

Among material produced and disseminated through the PR unit during the fiscal year 2005-06 were some 29 media releases, the *2004-05 Annual Report*; four regular issues of the quarterly newsletter, *The Navigator*, and quarterly reports to the Financial Secretary. Senior CIMA officials contributed articles, updates and messages at the request of several publications.

External Liaison

Numerous local and overseas media requests for information in pursuance of stories being prepared by reporters were dealt with and assistance was provided in response to calls and emails from members of the public and from government agencies.

During the year, the Public Relations Executive also liaised with the Government's Portfolio of Finance PR Office and CI Financial Sector Association's public relations and marketing advisers on a joint public-private sector programme to promote the financial sector among local residents.

Presentations

Senior staff and members of the Board of the Authority delivered numerous speeches and presentations at local and overseas conferences, meetings and seminars during the year. The major presentations delivered by CIMA officials, as well as the releases and publications mentioned are available in the "Media Centre" and "Publications" sections of CIMA's website (www.cimoney.com.ky).

FINANCIAL CONTROL

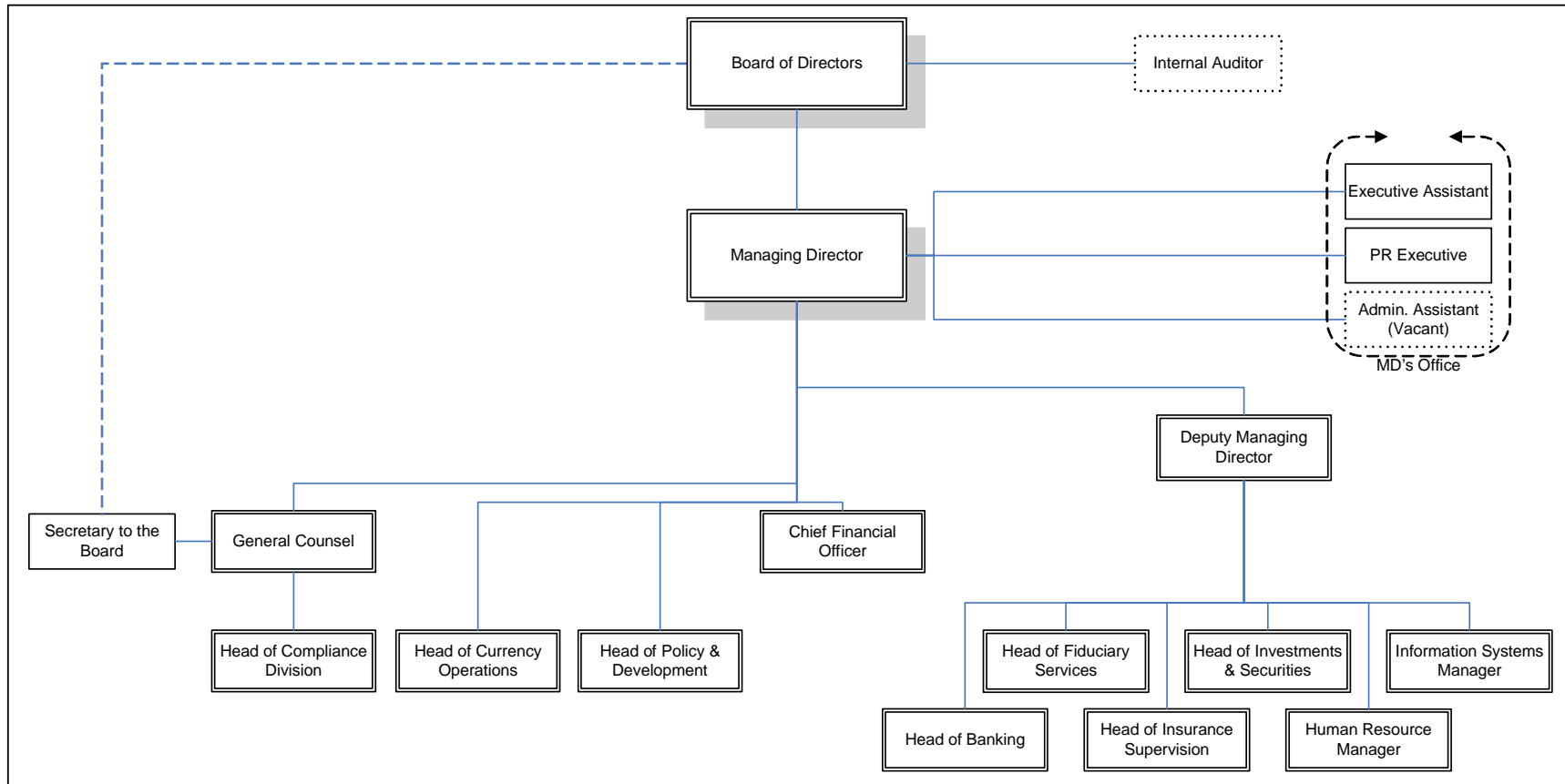
The Accounts Unit has responsibility for all financial matters relating to budget, annual licence fee collection, payroll, and accounts payable, and is responsible for preparation of CIMA's financial statements and the purchase & ownership agreements between the Cabinet and the Authority (see Appendix 1, "Role and Functions of the Monetary Authority - Relationship with Government"). The unit's objectives are essentially created by the financial requirements of the organization and its stakeholders and the resources available to it.

For a summary of fees collected, and income, expenditure and surplus for fiscal year 2005-06, see Table 16 – Financial and Personnel Resources, page 28.

APPENDIX 1

ABOUT THE CAYMAN ISLANDS MONETARY AUTHORITY

CIMA ORGANIZATIONAL CHART



Note: A full version of this chart is available in the About Us section of CIMA's website: http://www.cimoney.com.ky/uploadedFiles/About_Us/OrganisationalChart.pdf

DIRECTORS & SENIOR OFFICERS AS AT 30 JUNE 2006

Chairman	Timothy Ridley OBE
Deputy Chairman	Joel Walton
Managing Director	Cindy Scotland
Directors	Warren Coats PhD Richard W. Rahn PhD Bryan Bothwell Adriannie Webb Professor William Gilmore Carlyle McLaughlin Christopher Rose PhD
Deputy Managing Director	Patrick Bodden
Banking Supervision Division	Head of Banking Supervision: Malcolm Eden
Compliance Division	Head of Compliance: RJ Berry
Currency Operations Division	Head of Currency Operations: Cindy Scotland Deputy Head: Shan Whittaker
Fiduciary Services Division	Acting Head of Fiduciary Services: Rohan Bromfield
Insurance Division	Head of Insurance: Mary-Lou Gallegos Deputy Head Morag Nicol
Investments and Securities Division	Head of Investments and Securities: Gary Linford
Legal Division	General Counsel: Langston Sibblies Legal Counsel: Sandra Edun-Watler Legal Counsel: Candice Huggins
Managing Director's Office	Public Relations Executive: Joan Scott-Campbell
Operations Division	Chief Financial Officer: Gilda Moxam-Murray Human Resources Manager: Deborah Musson Information Systems Manager: Rodney Ebanks
Policy and Development Division	Head of Policy and Development: Mitchell Scott Deputy Head: Lisa Martine Bowyer

Note: Directors and senior officers' biographies are available on the CIMA website.²¹

²¹ <http://www.cimoney.com/ky/section/aboutus/default.aspx?id=59>

ROLE AND FUNCTIONS OF THE MONETARY AUTHORITY

The Cayman Islands Monetary Authority (CIMA) came into existence on 1 January 1997, an amalgamation of the former Cayman Islands Currency Board and the Financial Services Supervision Department. Established as a wholly government-owned body corporate, the Authority received full operational independence on 10 March 2003, through the Monetary Authority Law (2003 Revision). The key feature of this change was that powers previously vested in the Cabinet of the Cayman Islands to issue and revoke licences and for enforcement now vest in the Authority, through its Board of Directors.

CIMA has four **principal functions**.

1. **Monetary** - the issue and redemption of the Cayman currency and notes and the management of currency reserves.
2. **Regulatory** - 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. **Cooperative** - the provision of assistance to overseas regulatory authorities, including the execution of memoranda of understanding to assist with consolidated supervision.
4. **Advisory** – the provision of advice to the Government on monetary, regulatory and cooperative 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 the 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.

Relationship with Government

Cabinet retains the power to give the Monetary Authority directions in the public interest and to issue regulations including setting licence fees. Additionally, CIMA officials can be called before the Legislative Assembly, and Cabinet can appoint an independent person to review the Authority's performance. Cabinet also appoints the Board of Directors, which comprises up to 10 members who serve fixed terms of three years and are eligible for reappointment. The law sets out the circumstances in which a director's appointment can be terminated. No member of the Cabinet or the Legislative Assembly may sit on the board.

As a statutory authority under the Public Management and Finance Law, the Monetary Authority is subject to an annual statutory audit and the Legislative Assembly approves its annual budget and funding. For this purpose, the Authority and the Government enter into annual operating and purchase agreements under which the Government pays for specified regulatory and currency services provided by CIMA. These agreements are used to evaluate its performance.

Investment income earned on the currency reserve assets is paid over to the Government after the Authority satisfies all the reserve requirements at year-end. Industry licensing and operating fees collected by CIMA also belong to the Government.

Budget and Expenditure Controls – CIMA’s budget is compiled based on input from the Authority’s management team and is reviewed and approved by the CIMA Board of Directors before submission to the Portfolio of Finance and Economics for further review and approval. Thereafter it forms a part of the Government’s Annual Plan & Estimates. The Authority cannot exceed the government-approved budgeted expenditure. The total budgeted outputs are billed monthly to the Government. The monthly financial statements are presented to the CIMA Board and contain budget comparatives along with explanation for variances. CIMA submits quarterly and annual reports as required by the PMFL. These contain a summary of the output performance and financial information, with comparatives to budget and prior year.

Relationship with the Private Sector

The Monetary Authority’s accountability to the private sector has been formalized through a consultation process. This consultation must be done before issuing or amending rules or statements of principle or guidance regarding conduct of licensees and money laundering regulation. The process requires the Authority to explain the purpose of the measure, provide a cost/benefit analysis and allow a minimum of 30 days for comment. CIMA gives a written response to representations and forwards these, along with its response, to Cabinet.

Emergency exceptions are permitted. Final approval of rules and statements of guidance rests with Cabinet. The Authority is also required to make recommendations to 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.

As part of its statutory obligation of transparency and fairness, the Monetary Authority has produced a *Regulatory Handbook*. This publication, and its subsequent updates and amendments, sets out the policies and procedures followed by the Authority, its committees, and officers in performing their regulatory and cooperative functions. It includes details of the consultation process with the private sector associations and approval by Cabinet.

International Cooperation

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. From 2000 to 30 June 2005, CIMA processed a total of 526 requests for assistance and provided assistance in approximately 98 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 Cayman Islands law with respect to the use and protection of confidentiality of the information provided.

The Authority is also authorised to enter into memoranda of understanding (MOUs) in the exercise of its cooperative function. The MOUs provide the framework to facilitate cross-border cooperation on information exchange, including timely access to, and verification of, information. Copies of the Authority’s current MOUs are available on the CIMA website.²²

The Board of Directors and Other Committees

The board may delegate any of its duties and powers except those expressly imposed or conferred on it by the law. It has appointed the Executive Committee, comprising local directors, to make decisions on enforcement actions and applications for securities investment business licences. It has also delegated authority for licensing and supervisory decisions and related matters to the Management Committee, which consists of the management of the Monetary Authority.

To promote operational effectiveness, five sub-committees of the board have been established. These are:

²² <http://www.cimoney.com.ky/section/regulatoryframework/default.aspx?id=150>

1. the **Audit and Finance** Committee, which deals with the Monetary Authority's financial position and results of operations; 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;
2. the **Policy, Strategy and Relations** Committee, which, together with the Structure and Governance Committee and management, develops CIMA's strategic plan and procedures, as well as new rules, statements of guidance and principle and policies in conjunction with management, and submits recommendations to the board;
3. the **Structure and Governance** Committee, which advises the board on issues pertaining to the organizational structure and the direction and control of the Authority;
4. the **Legislative and Legal** Committee, which reviews and reports on any legal, legislative and regulatory matters referred to it either by the board or management, and which keeps local and international legal, legislative and regulatory developments relevant to the Monetary Authority under review with management; and
5. the **Human Resources** Committee, which advises the board on terms and conditions of staff employment, 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 every five to six weeks. These reports contain a listing of all licensing decisions taken, and all other recommendations provided to the Cabinet for consideration in relation to regulation and currency.

APPENDIX 2

**AUDITED FINANCIAL
STATEMENTS FOR THE YEAR
ENDED 30 JUNE 2006**

TABLE OF CONTENTS

	<u>Page</u>
Certificate and Report of the Auditor General	1
Balance Sheet	3
Income Sheet	4
Statement of Changes in Reserves and Capital	5
Statement of Cash Flows	6
Notes to the Financial Statement	7



Cayman Islands

The Cayman Islands Monetary Authority

CERTIFICATE OF THE AUDITOR GENERAL

To the Shareholder of the Cayman Islands Monetary Authority

I have audited the accompanying financial statements of the Cayman Islands Monetary Authority (“the Authority”) which comprise the balance sheet as of 30 June 2006 and the related statements of income, changes in reserves and capital and cash flows for the year then ended as set out on pages 3 to 17 and in accordance with the Section 52 (3) of the Public Management and Finance Law (2005 Revision).

Management’s Responsibilities for the Financial Statements

Management is responsible for the preparation and fair representation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriated accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor General’s Responsibility and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend upon the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Audit Qualification – Absence of updated information re: Net Retirement Benefit Position

As disclosed in Note 10 of the financial statements, pension contributions for eligible employees of the Authority are paid to the Public Service Pensions Fund which is administered by the Public Service Pensions Board. The latest actuarial valuation of the defined benefit plan as required under IAS 19 was calculated as of 01 July 2004 which resulted in a Net Retirement Asset of \$322,000. No further actuarial assessment had been performed to date by the Pensions Board to determine the value of the retirement plan as at 30 June 2006. The Authority, is therefore not able to quantify the amount for this financial year due to insufficient relevant and reliable information from the Pensions Board. Based on verbal confirmation from the Pensions Board's actuary that there will be a positive defined benefit asset for 2006, the Authority has assumed that there was no change in the Net Retirement Benefit Assets for the year ended 30 June 2006, in these financial statements.

Opinion

In my opinion, except for the possible effects of the absence of updated information on net retirement benefit position, these financial statements present fairly, in all material respects, the financial position of the Cayman Islands Monetary Authority as at 30 June 2006 and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Monetary Authority Law (2004 Revision).



Dan Duguay MBA, FCGA
Auditor General

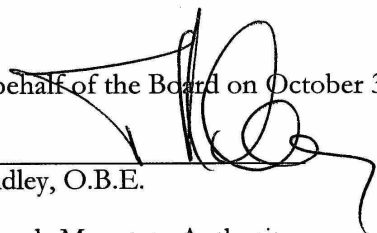
31 October 2007


CAYMAN ISLANDS MONETARY AUTHORITY BALANCE SHEET

As at June 30 2006
(Expressed in Cayman Islands Dollars)

	Note	30 June 2006 \$	30 June 2005 \$
ASSETS			
<i>Currency Reserve Assets</i>			
Call Deposits	3b	2,252,660	13,707,406
Fixed Deposits	3b	1,374,107	1,323,494
Interest Receivable, Deposits		264,197	93,649
Short-Term Investments	2b, 3a	44,932,936	52,233,439
Long-Term Investments	2b, 3a	41,607,278	21,990,409
Stocks	2f, 6	1,782,394	806,734
<i>Total Currency Reserve Assets</i>		<u>92,213,572</u>	<u>90,155,131</u>
<i>Operating Assets</i>			
Current and Call Deposits	3b	1,500,573	2,437,297
Accounts Receivable	2j,4	3,728,419	29,669
Other Receivables and Prepayments		90,148	57,181
Fixed Assets	2e, 5	961,874	300,812
Retirement Benefit Assets	10	322,000	0
<i>Total Operating Assets</i>		<u>6,603,014</u>	<u>2,824,959</u>
TOTAL ASSETS		<u>98,816,586</u>	<u>92,980,090</u>
LIABILITIES			
Demand Liabilities, Currency in Circulation	7a	70,558,404	72,822,604
Due to the CI Government	9b	3,004,121	0
Other Liabilities and Payables	2k, 7b	1,882,788	736,346
<i>Total Liabilities</i>		<u>75,445,313</u>	<u>73,558,950</u>
RESERVES and CAPITAL			
General Reserve	9a	10,583,760	10,923,390
Currency Issue Reserve	9c	446,593	519,730
Capital Expenditures Reserve	9e	2,615,900	0
<i>Total Reserves</i>		<u>13,646,253</u>	<u>11,443,120</u>
Paid Up Capital	9d	9,725,020	7,978,020
<i>Total Reserves and Capital</i>		<u>23,371,273</u>	<u>19,421,140</u>
TOTAL LIABILITIES, RESERVES and CAPITAL		<u>98,816,586</u>	<u>92,980,090</u>

Signed on behalf of the Board on October 31, 2007


 Timothy Ridley, O.B.E.
 Chairman
 Cayman Islands Monetary Authority


 Cindy Scotland
 Managing Director
 Cayman Islands Monetary Authority

The notes on pages 7 to 17 are an integral part of these financial statements

CAYMAN ISLANDS MONETARY AUTHORITY
INCOME STATEMENT

For the year ended 30 June 2006
(Expressed in Cayman Islands Dollars)

	Note	2006 \$	2005 \$
INCOME			
		12,495,24	
Outputs	2d,12	0	9,272,062
Investment Income	2b	3,945,641	2,555,311
Commission Income	2d	812,504	610,993
Numismatic Income	2d	258,809	74,927
Other Income		4,089	1,632
Asset Disposal Gain		400	0
		17,516,68	12,514,92
Total Income		3	5
OPERATING EXPENSES			
Salaries and Other Benefits		6,896,792	5,898,036
General and Administrative		1,416,583	1,212,127
Pension Contributions	2i, 10	588,420	606,027
Depreciation	2e, 5	208,680	153,045
Lease Rental	8	438,908	312,113
Staff Training and Recruitment		233,377	200,285
Official Travel		409,818	332,226
Management and Custody Fees	3a	135,829	110,772
Professional Fees		789,307	347,633
Directors Fees		254,299	275,297
Realised Loss on Investments		339,279	512,019
Unrealised Loss on Investments		0	123,643
			10,083,22
Total Expenses		11,711,292	3
NET INCOME		5,805,391	2,431,702

The notes on pages 7 to 17 are an integral part of these financial statements

CAYMAN ISLANDS MONETARY AUTHORITY
STATEMENT OF CHANGES IN RESERVES AND CAPITAL

For the year ended 30 June 2006
(Expressed in Cayman Islands Dollars)

	2006				2005		
	General Reserve	Currency Issue Reserve	Paid-up Capital	Capital Expenditure Reserve	General Reserve	Currency Issue Reserve	Paid-up Capital
Balance at 1 July	\$10,923,390	\$519,730	\$7,978,020	\$0	\$8,213,057	\$615,038	\$8,125,000
Transfers in :							
From Government			900,000				131,650
From Net Income	5,805,391				2,431,702		
From General Reserve			525,000	2,615,900			
From Paid -up Capital					278,630		
Retirement Benefit Assets			322,000				
Transfers out:							
To General Reserve							(278,630)
To Paid-up Capital	(525,000)						
To Capital Expenditure Reserve	(2,615,900)						
Contribution Payable to CI GOVT	(3,004,121)						
Cost of currency inventory issued during the year		(73,137)				(95,308)	
Balance at 30 June	\$10,583,760	\$446,593	\$9,725,020	\$2,615,900	\$10,923,390	\$519,730	\$7,978,020

The notes on pages 7 to 17 are an integral part of these financial statements

CAYMAN ISLANDS MONETARY AUTHORITY
STATEMENT OF CASH FLOWS

For the year ended June 30 2006
(Expressed in Cayman Islands Dollars)

	2006	2005
	\$	\$
Cash flows from operating activities		
Net Income	5,805,391	2,431,702
Adjustments for items not involving cash:		
Add: Depreciation	<u>208,680</u>	<u>153,045</u>
Add:		
Less: Gain on Fixed assets disposal	<u> </u>	<u> </u>
Operating profit before working capital changes	6,014,071	2,584,747
Net change of investments	(12,316,365)	(7,557,265)
Interest Receivable	(170,550)	40,748
Accounts Receivable	(3,698,750)	119,067
Other Receivables and Prepayments	(32,964)	(29,401)
Other Liabilities and Payables	1,146,440	322,138
Stocks	<u>(975,660)</u>	<u>21,969</u>
Cash used by Operations	(10,033,778)	(4,497,997)
(Decrease)/Increase in Demand Liabilities	(2,264,200)	18,068,888
Decrease in Currency Issue Reserve Cost of Currency Notes Reprint	<u>(73,137)</u>	<u>(95,308)</u>
<i>Net cash (used by)/generated from operating activities</i>	<u>(12,371,115)</u>	<u>13,475,584</u>
Investing Activities		
Acquisition of fixed assets	(872,754)	(42,122)
Proceeds from fixed assets disposal	<u>3,012</u>	<u>0</u>
<i>Net cash used by investing activities</i>	<u>(869,742)</u>	<u>(42,122)</u>
Financing Activities		
Contribution received from CI Government	900,000	131,650
Contribution Paid to CI Government	<u>0</u>	<u>(619,881)</u>
<i>Net cash provided by /(used by) financing activities</i>	<u>900,000</u>	<u>(488,231)</u>
(Decrease)/Increase in cash and cash equivalents	<u>(12,340,857)</u>	<u>12,945,230</u>
Movement in cash and cash equivalents		
Balance at July 1	17,468,197	4,522,967
(Decrease)/Increase	<u>(12,340,857)</u>	<u>12,945,230</u>
Balance at 30 June (Note 3b)	<u>5,127,340</u>	<u>17,468,197</u>

The notes on pages 7 to 17 are an integral part of these financial statements

CAYMAN ISLANDS MONETARY AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

1. **Organization and Objectives**

The Cayman Islands Monetary Authority (the "Authority") was established under The Monetary Authority Law, 1996 (the "Law") on 1 January 1997. Under the Monetary Authority Law (2004 Revision) (the "Law (2004 revision)"), the primary objectives of the Authority are (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.

As at 30 June 2006, the Authority has 104 employees (30 June 2005: 95). The Authority is located in Elizabethan Square, George Town, Grand Cayman, Cayman Islands.

2. **Significant Accounting Policies**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

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 Financial Reporting 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) Revenue recognition. The Authority depends on the sale of its Outputs to the Cabinet of the Government of the Cayman Islands, as its main source of income to meet its obligations. The Authority's other sources of income are generated from its investments, bank balances, and other currency transactions. The Authority recognizes revenue as it is earned.

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 (with the exception of Bank Note Sorting machine calculated at 15% and DRC Equipment calculated at 33.33%) and Motor Vehicle; and 25% to 33.33% 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.

CAYMAN ISLANDS MONETARY AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

Significant Accounting Policies (continued)

Stocks (continued).

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 Note 6).

g) Numismatic Coins. The total nominal value of numismatic coins outstanding at 30 June 2006 is \$14,659,056 (30 June 2005: \$14,704,652). 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

Pension Plans. The Authority makes pension contributions for its eligible employees to the Public Service Pensions Fund, which is administered by the Public Service Pensions Board. The Fund has both a defined benefit and a defined contribution element. There are a small number of employees who participate in other private plans, which are all defined contribution schemes.

Under defined contribution plans, the Authority pays fixed contributions and has no obligation to pay further contributions if the fund does not have sufficient assets to pay employee benefits relating to employee service in the current and prior periods. The Authority recognises contributions to a defined contribution plan when an employee has rendered services in exchange for those contributions.

A defined benefit plan is one that defines an amount of benefit to be provided, usually as a function of one or more factors such as age, years of service or compensation. The asset or liability in respect of defined benefit plans is the difference between the present value of the defined benefit obligation at the balance sheet date and the fair value of plan assets, adjusted for unrecognised actuarial gains/losses and past service cost. Where a pension asset arises, the amount recognised is limited to the net total of any cumulative unrecognised net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reduction in future contributions to the plan. The pension costs are assessed using the Projected Unit Credit Method. Under this method the cost of providing pensions is charged in the Income Statement so as to spread the regular cost over the service lives of employees in accordance with advice of the actuary, (who is due to carry out a full valuation of the plans every year). The pension obligation is measured at the present value of the estimated future cash outflows using discount estimated rates based on market yields on high quality corporate bonds at the time of the accounting date which have terms to maturity approximating the terms of the related liability.

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 10).

Other Benefits. Other employee benefits include maternity leave, sick leave, vacation days and performance awards. Vacation days accumulate and vest and therefore a liability is accrued each year. The accrued vacation liability as of 30 June 2006 is \$206,184 (2005 - \$188,908) and is included in the other liabilities and payables.

CAYMAN ISLANDS MONETARY AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006
(Expressed in Cayman Islands Dollars)

Significant Accounting Policies (continued)

- j) Accounts Receivable. The receivables are stated at original invoice amount. (See also note 4).
- k) Accounts Payable. The payables are stated at historical cost.

3. Currency Reserve Assets

Sections 32(8) of the Law (2004 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. (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 9a.)

Under the Law (2004 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 2006, the value of Currency Reserve Assets was \$92,213,572 (30 June 2005: \$90,155,131) representing 130.69% (30 June 2005: 123.80%) of total demand liabilities. The value of external assets equated to 127.30% (30 June 2005: 120.68%) while the value of local assets equated to 3.39% (30 June 2005: 3.12%) 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 Law (2004 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 year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

Currency Reserve Assets (continued)

Long-term investments

Long-term investments are made up of Mortgage-backed Securities stated at market value, with interest rates ranging from 1.35% to 8.0%. Maturity dates range from 15/03/2007 to 01/07/2036. Although the stated maturity date on eight of the securities is over 10 years the expected duration is less than 10 years.

	2006	2005
<i>Range of maturities:</i>	\$	\$
1 – 5 Years	11,937,402	16,836,075
6 – 10 Years	379,745	1,145,640
Over 10 Years	29,290,131	4,008,694
	\$41,607,278	\$21,990,409

Short-term investments

Discount notes / Treasury Bills		
Maturing from 03/07/06 to 26/07/06	16,349,603	22,400,106
Repurchase Agreement		
Federal Reserve at 4.49% maturing 03/07/06	28,583,333	29,833,333
	\$44,932,936	\$52,233,439
 Total short-term investments, at amortized cost	\$44,932,936	\$52,233,439
	\$44,935,838	\$52,232,776

b) Bank Deposits.

The Authority maintains current, call and fixed deposits with domestic and foreign banks. Under the Law (2004 revision), domestic deposits (as part of the Currency Reserve Assets) cannot exceed 10% of demand liabilities. At 30 June 2006, domestic deposits represent 3.39% (30 June 2005: 3.12%) of demand liabilities.

	Holding Currency	2006	2005
		\$	\$
i) <u>Current and Call Deposits</u>			
Current account	KYD	(105,548)	(83,452)
Call deposits	KYD	1,605,721	2,520,449
Cash on hand	KYD	400	300
		\$1,500,573	\$2,437,297
ii) <u>Currency Reserve Assets</u>			
<u>Domestic Deposits</u>			
Savings	KYD	4,152	0
Call deposits	USD	1,010,107	943,287
Call deposits	GBP	6,514	6,741
<u>Foreign Deposits</u>			
U.S. Federal Reserve call account	USD	98,028	161,072
Investment portfolio, call account	USD	1,133,859	12,596,306
		\$2,252,660	\$13,707,406
		\$1,374,107	\$1,323,494
Total Operating Cash and Currency Reserve Assets		\$5,127,340	\$17,468,197

CAYMAN ISLANDS MONETARY AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

Currency Reserve Assets (continued)

Interest is paid on domestic call and fixed deposits at rates ranging from 1.75% to 4.99% (30 June 2005: 0.35% to 1.1%) per annum.

Interest of 3% (30 June 2005: 1.2%) 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. Accounts Receivable

	2006	2005
	\$	\$
Outputs & Capital Grants	3,704,821	0
Other receivables	23,598	29,669
Provision for Doubtful Debt	0	0
	_____	_____
Total Accounts Receivable	\$3,728,419	29,669

5. Fixed Assets

	Furniture & Fixtures	Leasehold Improvement	Computer Equipment	Office Equipment	Motor Vehicle	Total
	\$	\$	\$	\$	\$	\$
Original Cost						
Balance at 01/07/05	444,825	422,915	786,226	411,845	24,600	2,090,411
Additions	207,641	216,263	377,967	70,883	0	872,754
Disposals	0	0	(19,870)	(7,300)	0	(27,170)
Balance at 30/06/06	652,466	639,178	1,144,323	475,428	24,600	2,935,995
Accumulated Depreciation						
Balance at 01/07/05	404,604	422,915	704,835	232,645	24,600	1,789,599
Charge for the year	36,968	14,394	109,303	48,015	0	208,680
Relieved on disposals	0	0	(19,870)	(4,288)	0	(24,158)
Balance at 30/06/06	441,572	437,309	794,268	276,372	24,600	1,974,121
Net Book Value at 30/06/06	210,894	201,869	350,055	199,056	0	961,874
Net Book Value at 30/06/05	40,221	0	81,391	179,200	0	300,812

CAYMAN ISLANDS MONETARY AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006
 (Expressed in Cayman Islands Dollars)

6. Stocks

	2006	2005
	\$	\$
Bullion from the melt-down of coins	318,071	202,142
Coins awaiting melt-down	234,711	134,503
Coins for resale	110,543	78,903
Museum items	34,959	24,585
Inventory of unissued currency notes and coins	1,084,110	366,601
	<hr/>	<hr/>
Total Stocks	\$1,782,394	\$806,734
	<hr/> <hr/>	<hr/> <hr/>

7. 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:		2006	2005
		\$	\$
i)	Currency notes in circulation	62,721,911	65,396,325
ii)	Currency coins in circulation	7,836,493	7,426,279
		<hr/>	<hr/>
	Total	\$70,558,404	\$72,822,604
		<hr/> <hr/>	<hr/> <hr/>

b) Other liabilities. At 30 June 2006, other liabilities included unsettled investment management and custody fees of \$42,357 (30 June 2005: \$51,527).

8. Lease Obligation

The Authority leases the premises used under various lease agreements. Rental payments under operating leases are charged to the income statement in equal installments over the period of the lease.

Parcel	Location	Area	Current Cost	Current Lease Agreement	Future Lease Arrangements
159/141	Phase IV - ground fl+2nd Fl+ 1/2 of 3rd Fl	11229 sq.ft	\$28 per sq.ft	Jan-1-06 to Dec-31-06	Renewal Option / \$29 per sq.ft
159/142	Block B 2nd Fl - Unit 209	800 sq.ft	\$28 per sq.ft	Jan-1-06 to Dec-31-06	Renewal Agreement / \$28 per sq.ft
159/144	Block C 2nd Fl - Unit 202	800sq.ft	\$30 per sq.ft	Dec-1-05 to Nov-30-06	Renewal Agreement / \$30 per sq.ft
159/138	Phase III - 2nd Fl	1294 sq.ft	\$30 per sq.ft	Jun-01-05 to May-31-06	Pay by letter until Dec 2006 / Renewed in 2007
159/157	Phase III - 2nd Fl	563 sq.ft	\$30 per sq.ft	Jun-01-05 to May-31-06	Pay by letter until Dec 2006 / Renewed in 2007
159/145	Phase III - 4th Fl	2857 sq.ft	\$31 per sq.ft	Jan-1-06 to Dec-31-06	Renewal Agreement / \$31 per sq.ft

CAYMAN ISLANDS MONETARY AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

9. Reserves and Capital

a) General Reserve. The Authority maintains a General Reserve in accordance with Section 8 of the Law (2004 revision). The Authority shall maintain the General Reserve 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 (2004 revision), the net profits of the Authority, after provision for all expenditure and reserves, shall be allocated such that the Currency Reserve Assets represent at least 100% of demand liabilities and the General Reserve does not exceed 15% of demand liabilities. Any surplus not allocated in accordance with the above shall be transferred 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). 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 \$9,725,020 as at 30 June 2006 (30 June 2005: \$7,978,020). The Cabinet 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.

e) Capital Expenditure Reserve. Under Section 9 of the Law (2004 revision), the net profits of the Authority for any financial year shall include, but shall not be limited to, the income from the investments of the Authority, and the profit from the sales of investments belonging to the Authority, and shall be determined by the Authority after meeting or providing for all expenditure for that year and making such provisions for contingencies and the establishment of such additional reserves as it may consider desirable. This Reserve has been created to provide for key new capital projects, in particular the E-Filing Project.

CAYMAN ISLANDS MONETARY AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

10. Pensions

Pension contributions are paid for all eligible employees on their pensionable emoluments. The majority of the employees are participants in the Public Service Pensions Plan, with a small number participating in other private plans, which are all defined contribution schemes.

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. 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, with participants joining after 1 January 2000 becoming members of the defined contribution element only.

Using the projected Unit Credit method of measuring costs and obligations, the actuarial assessment for the Authority assessed the minimum normal annual contribution to be 13 % in 2005-6 (13% in 2004-5). This rate included a 1% for the cost of all of the benefits that are provided over and above those related to the participant's total account balance. Certain participants are reimbursed for their contributions.

The Plans are funded at rates of: -

	2006	2005
Defined Contribution Plans - Employee	6%	6%
- Employer	7%	7%
Defined Benefit Plans - Employee	6%	6%
- Employer	7%	7%

The assessment on the Authority's position in the Fund based on the 1 January 2005 Actuarial Valuation Report (dated March 2007) indicated that contribution rates should continue at 13% for the defined benefit scheme and 13% for the defined contribution scheme.

The pension plan has been accounted for under paragraphs 44-46 of International Accounting Standard 19 as if it were a defined contribution plan, as sufficient information is not available on the Fund to fully use defined benefit accounting. The Actuary to the Pensions Board has valued the Fund. The defined contribution part of the Fund is not subject to the special actuarial valuations due to the nature of the benefits provided therein.

The total amount recognised as a pension expense during 2005-6 was \$588,420 (2004-5: \$606,027). The actual amount of pension expense relating to the defined benefits for staff should also include the effect of the changes in the actuarial determined liability. However, since such information is not yet available from the actuary of the Pensions Board, management is unable to determine the impact on the recorded expense for the years ended 30 June 2006 and 2005.

CAYMAN ISLANDS MONETARY AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

Pensions (continued)

The schemes are valued by independent Actuaries.

The latest actuarial valuation (of the defined benefit plan) was done as at 1 July 2004.

	1 July 2004	
Net Present Value of Funded Obligation	(1,870,000)	\$
Fair Value of Plan Assets	<u>2,192,000</u>	
	322,000	
Unrecognised Past Service Cost	0	
Unrecognised Actuarial Gains/(Losses)	0	
	<u>322,000</u>	
Net Assets in Balance Sheet	<u><u>322,000</u></u>	

The Actuary to the Pensions Board is of the opinion that it is likely that the Authority will still have a positive defined benefit asset as of 30 June 2006, based on the discount rate as at 30 June 2006 (which was 6.25%), the liability experience and the asset performance during the two years, and the relationship between the pension expense and contribution for these two years. However, the amount of the positive defined benefit asset at 30 June 2006 and 2005 cannot be determined by management at this time, as there has been no update to the actuary's report since 1 July 2004.

The Distribution of the Plan Assets, at 1 July 2004, based on the share of the total Fund allocated to the Authority was as follows: -

Global Equities	25.3%
US Equities	1.2%
Bonds	46.6%
Other	3.3%
Cash	4.1%
Cash - Term Deposits	19.5%

The principal Actuarial Assumptions at the date of valuation

A. Cost Method - Projected Unit Credit

B. Economic Assumptions -

1. Discount Rate - 6.50%
2. Expected long-term rate of return (net of Expense) - 7.00%
3. Salary Increase - 4.00%
4. Future Pension Increases - 2.50%
5. Expected remaining working lives (years) - 15.92
6. Inflation Rate - 2.5%

C. Other Assumptions -

1. Mortality - Standard U.S. mortality rates
2. Retirement Age - completion of age 57 and 10 years of service

D. Asset Valuation - Fair (Market) Value

CAYMAN ISLANDS MONETARY AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

11. Financial Instruments

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.

12. Related Party Transactions

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 2006.

The following Government departments/entities provided services to the Authority during 2005-6:

- i) Audit Office at a cost of \$35,000 (2004-5: \$30,000)
- ii) Internal Audit Office
- iii) Cayman Islands Investment Bureau
- iv) Computer Services Department
- v) Legal Department
- vi) Public Service Pension Board (see Note 9)
- vii) Public Works Department
- viii) Department of Environmental Health
- ix) Royal Cayman Islands Police Services

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 form a part of the outputs purchased by Government.

The Authority's main source of revenue is from the sale of its Outputs to the Cabinet of the Government of the Cayman Islands, which is used to cover the Authority's recurrent expenditure. A grant from the Government funds the Authority's 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 year ended 30 June 2006

(Expressed in Cayman Islands Dollars)

13. Additional Bank Accounts

In 2005-6 the Authority continued to maintain a segregated insurance fund account with a local bank to collect funds from health insurance providers (as specified under regulation 5 of the Health Insurance Regulation (2002 Revision)). In June 2006 the account was closed and the funds transferred to the Health Insurance Commission.

The Authority also maintains an interest bearing account with another local bank established to receive a draw down on Letter of Credit as a consequence of default by an insurance company. By virtue of Section 7(1) of the Insurance Law (2004 Revision) every insurance company carrying on domestic business in the Cayman Islands must have funds set aside for liability support to their policyholders in the event the company defaults on its financial obligations in this jurisdiction.

The account balance was \$1,582,576 as at 30 June 2006. This balance will be disbursed according to the directions from the Grand Court of Cayman Islands. This account is also in the name of the Authority but is not included as a part of the Authority's assets. In accordance with instructions issued by the Grand Court of the Cayman Islands on August 9, 2007, this account in the amount of \$1,621,757 was closed and the funds handed over to the Joint Official Liquidators on August 15, 2007.