

Article

The Lawfulness of Insuring ‘Morally Hazardous’ Business in the Cayman Islands

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The Cayman Islands has become a hub for financial reinsurance and captive entities. These entities often write or reinsure traditional property and casualty risks emanating from various underlying businesses. Insurance is international and cross-border with the globalisation of insurance products and markets evolving at a rapid pace. As these products and markets evolve so does the diversity of the types of businesses seeking to avail themselves of captive and reinsurance structures. However, difficulties can arise when an underlying business is engaged in activities that are unlawful in the Cayman Islands such as the production and supply of cannabis.¹ In these situations, insurance managers need to satisfy themselves as to whether any Cayman Islands law is contravened by the captive writing traditional risks or a reinsurance entity providing reinsurance for an underlying business that is engaged in the production and supply of cannabis in a jurisdiction outside the Cayman Islands. This article discusses some of the key statutory provisions that would need to be considered.

Relevant Cayman Islands Law

The following is a list of some of the key related regulatory laws in the Cayman Islands;

- (i) The Proceeds of Crime Act (2020 Revision);
- (ii) The Criminal Procedure Code (2020 Revision)
- (iii) The Anti - Money Laundering Regulations (2020 Revision);
- (iv) The Penal Code (2019 Revision);
- (v) The Misuse Of Drugs Act (2017 Revision);
- (vi) The Insurance Act (2010 Revision)

For the purposes of this article, we have focused on the Proceeds of Crime Act (2020 Revision) (the ‘POCA’) and the Misuse of Drugs Act (2017 Revision) (the ‘MDA’). However, each matter will be determined on its own facts and would need to be considered in light of the application of the relevant regulatory law.

The MDA

The MDA is the principal legislation governing drug related offences in the Cayman Islands. Under section 3(1) of the MDA, a person who, without lawful excuse or without being authorised in that behalf:

- (a) imports;
- (b) exports;
- (c) produces;

¹ As of May 2017, medical cannabis became legal in the Cayman Islands as a prescribed drug to treat pain management. The recreational use of the drug is illegal under Cayman law.

- (d) stores;
- (e) sells, buys or otherwise deals in;
- (f) supplies;
- (g) distributes;
- (h) dispenses;
- (i) issues a prescription for;
- (j) administers;
- (k) possesses, constructively or otherwise;
- (l) consumes; or
- (m) has in his possession, whether lawfully or not, with intent that it be supplied, whether by himself or some other person, and whether in the Islands or elsewhere to another person in contravention of this subsection,

any controlled drug, pipe, utensil or thing used in the preparation or consumption of any controlled drug, or who attempts, assists or is concerned in any of such matters commits an offence.

Section 3(2) of the MDA states that a person commits an offence if, without lawful excuse or without being authorised in that behalf (a) being the occupier or concerned in the management of any premises, he permits or suffers any of the following activities to take place on those premises, that is to say producing, supplying, distributing, administering or consuming or attempting to do any of such things in contravening of section 3(1), or (b) frequenting any place used for the purpose of consuming any controlled drug.

If a business was engaged in any of the above activities within the territorial limits of the Cayman Islands, an offence could be committed. However, if these activities are not taking place in the Cayman Islands there should be no potential of criminal liability in the jurisdiction pursuant to the MDA. The MDA only applies to activities within the territorial limits of the Cayman Islands and has limited extraterritorial affect.²

It is still necessary, however, to consider whether the proceeds of activities constitute proceeds of crime, in particular, considering that the POCA is much wider than the MDA and has extraterritorial reach.

The POCA

The POCA focuses on property of all description that represents the proceeds of crime and is the principal legislation dealing with the proceeds of crime and money laundering in the Cayman Islands.

There are two key definitions in the POCA that underpin many of its provisions, those definitions are “unlawful conduct” and “criminal conduct”. Unlawful conduct is relevant to Part IV of the POCA as it determines the extent to which the proceeds of crime can be the subject of civil recovery or civil forfeiture in legal proceedings in the Cayman Islands. Criminal conduct is of primary relevance to Part V of the POCA as it determines the type of conduct or activity, which may lead to one or more money laundering offences being committed under that Part V.

Unlawful Conduct

Pursuant to Part IV section 78 of the POCA, “unlawful conduct” is defined as follows:

“conduct occurring in any part of the Islands is unlawful conduct if it is unlawful under the criminal laws of the Islands. Further, conduct which (a) occurs in a country outside the Islands and is unlawful under the criminal law of that country; and (b) if it occurred in the Islands, would be unlawful under the criminal law of the Islands is also unlawful conduct in the context of the POCA”

The POCA has extraterritorial reach in that proceeds of activities conducted in a jurisdiction outside the Cayman Islands can be subject to the Cayman Islands’ judicial powers under Part IV of the POCA but only if those activities constitute crimes in both the Cayman Islands and the other jurisdiction. The requirement for foreign conduct to be a crime under the laws of both jurisdictions means that if the conduct is not a crime under the law of the country where it occurs, it will not constitute unlawful conduct under the POCA even if

² Section 34(1) of the MDA provides for enforcement of external confiscation orders.

that conduct would be a crime if it occurred within the Cayman Islands. Proceeds of activities outside of the Cayman Islands can be subject to the enforcement powers under the POCA, but only if those activities constitute crimes in both jurisdictions.

Under Cayman law, the production and supply of cannabis remains an offence pursuant to the MDA. Therefore, a cannabis business would be deemed to be engaging in “unlawful conduct” under the POCA unless it can be established that it is not unlawful under the criminal law in the country that it is operating in. This proof can be readily satisfied for jurisdictions such as Canada where the production and supply of cannabis has been made lawful throughout the jurisdiction, however, it becomes less straightforward when having to navigate between the differences in State and Federal Laws in the United States. In the United States, a cannabis business can be acting wholly lawfully within the State that it is operating in despite the fact that cannabis remains illegal under Federal Law.³ More clarity on the legalisation at federal level would certainly be required to ease any apprehensions of insurers in this area.

Criminal Conduct

“Criminal conduct” for the purposes of the POCA is defined as “conduct which (a) constitutes an offence in any part of the Islands; or (b) would constitute an offence in any part of the Islands if it occurred there”.

As mentioned above, criminal conduct is of primary relevance to Part V of the POCA as it determines the type of conduct or activity which may lead to one or more money laundering offences being committed under that Part V. The principal money laundering offences are in summary: concealing etc. criminal property (section 133 of the POCA); being involved in arrangements with regard to criminal property (section 134 of the POCA); the acquisition, use or possession of criminal property (section 135 of the POCA); failure to disclose knowledge or suspicion of criminal conduct (section 136 of the POCA); and failure by a nominated officer (e.g. a money laundering reported officer) to disclose knowledge or suspicion of criminal conduct (section 137 of the POCA).

It might appear that the definition of “criminal conduct” set out above would bring a cannabis business within scope of the POCA as such operations would constitute a crime in the Cayman Islands if undertaken in the Cayman Islands. However, sections 133, 134, 135, 136 and 137 of the POCA provide a statutory defence in that a person does not commit the relevant offence if they know or believe on reasonable grounds that the criminal conduct is occurring in a particular country or territory outside the Islands and the criminal conduct is not unlawful under the criminal law applying in that country or territory.

For a cannabis business, operating lawfully within a State in the United States it can be readily satisfied that it is not engaged in criminal conduct on the basis that it is acting lawfully within its territory. However, it is not as easy to satisfy the definition of unlawful conduct considering that the business will be unable to establish that it is not unlawful as a matter of criminal law in the US considering the differences between State and Federal Law and in particular, while cannabis remains illegal under Federal Law. No such issues arise when dealing with an underlying business operating in Canada or another jurisdiction if it is operating lawfully as per the laws applicable throughout the jurisdiction.

Conclusion

There is a significant interest in cannabis businesses looking for alternative methods of insuring their business by the use of captives and reinsurance entities. Each case needs to be assessed on its own facts in determining whether a Cayman captive or reinsurance entity could write or reinsure traditional property risks and casualty risks emanating from the underlying business that is engaged in the sale and supply of cannabis. Under the MDA the prime focus will be to ensure that the activities do not have extraterritorial reach and that they are not occurring with the jurisdiction of the Cayman Islands. Under the POCA, the business would need to ensure that it is not engaged in “unlawful” or “criminal” conduct. In this regard, it would need to establish that it is not just acting lawfully within the territory in which it is operating but that it is also not acting unlawfully under any criminal law in the country that it is operating in.

Notwithstanding the above, the Cayman Islands Monetary Authority, as the regulator of insurance businesses in the Cayman Islands, has an absolute discretion on these matters and can refuse a license to a Cayman insurer if it is not in the public interest. Therefore, each case will be considered and determined on its own facts before a captive or a reinsurance entity can write or provide reinsurance for conventional property risk associated with a cannabis business.

For further information, please contact your usual Conyers lawyer or one of the contacts listed below.

³ The US House of Representatives passed the Marijuana Opportunity Reinvestment and Expungement Act (“MORE Act”) in early December 2020, which if passed by the Senate would eliminate criminal penalties for distribution, manufacturing and possession of marijuana. There is further possibility of incremental reforms in the form of the Secure and Fair Enforcement (SAFE) Banking Act (“SAFE Act”) and the Clarifying Law Around Insurance of Marijuana (CLAIM) Act. These bills provide a legal harbor for providing financial and insurance services to cannabis related business.

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