

# CAYMAN ISLANDS MONETARY AUTHORITY

## PRIVATE SECTOR CONSULTATION



### **2019 AMENDMENTS TO THE GUIDANCE NOTES ON THE PREVENTION AND DETECTION OF MONEY LAUNDERING AND TERRORIST FINANCING IN THE CAYMAN ISLANDS OF DECEMBER 13, 2017**

#### **A. Introduction**

1. Section 34(1)(c) of the Monetary Authority Law (2018 Revision) ("MAL") states:

"After private sector consultation and consultation with the Minister charged with responsibility for Financial Services, the Authority may –

*(c) issue or amend rules or statements of principle or guidance to reduce the risk of financial services business being used for money laundering or other criminal purposes;"*

2. Subsection 34(4) states "[t]he guidance notes referred to as "The Guidance Notes on the Prevention and Detection of Money laundering in the Cayman Islands" issued on the 26<sup>th</sup> April 2001, shall be deemed to have been issued under subsection (1)".
3. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

*"When this Law requires private sector consultation in relation to a proposed measure –*

*(a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*

- (i) an explanation of the purpose of the proposed measure;*
- (ii) an explanation of the Authority's reasons for believing that the proposed measure is compatible with the Authority's functions and duties under section 6;*
- (iii) an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
- (iv) an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
- (v) notice that representations about the proposed measure may be made to the Authority within a period specified in the*

*notice (not being less than thirty days or such shorter period as may be permitted by subsection (3)); and*

*(b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations."*

4. The Cayman Islands Monetary Authority ("Authority" or "CIMA") seeks consultation and comment from the private sector associations concerning the following proposed amendments to the Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands of December 13, 2017 ("GNs"):
  - (a) Proposed amendments to "Assessing Risks and Applying a Risk-Based Approach" (attached as **Appendix A**);
  - (b) Proposed amendments regarding ongoing monitoring (attached as **Appendix B**); and
  - (c) Proposed addition regarding Virtual Asset Service Providers ("VASPs") (attached as **Appendix C**).
5. The proposed amendments and addition to the GNs are discussed in Section C as follows:
  - (a) **Part 1:** Proposed Amendments to "Assessing Risks and Applying a Risk-Based Approach";
  - (b) **Part 2:** Proposed Amendments regarding Ongoing Monitoring; and
  - (c) **Part 3:** Proposed Addition regarding Virtual Asset Service Providers.
6. Section D highlights implementation in other jurisdictions (where relevant); and the Costs & Benefits Analysis is presented in Section E.

**B. Overall Purpose of the Proposed Amendments and Consistency with the Authority's Functions**

1. In December 2017 the Caribbean Financial Action Task Force ("CFATF") conducted a fourth-round mutual evaluation on the framework for Anti-Money Laundering and Counter-Terrorism Financing (AML/CFT) in the Cayman Islands against the Financial Action Task Force's 40 Recommendations and 11 Immediate Outcomes ("FATF Recommendations"). The CFATF's mutual evaluation report ("MER") was published on March 18, 2019. The follow-up review process, aimed at assessing the extent at which deficiencies are addressed, takes place in February 2020.
2. Section 6(1) of the MAL provides that the principal responsibilities of the Authority include its regulatory functions, including-

*"(b)(i) to regulate and supervise financial services business carried on in or from within the Islands in accordance with this Law and the regulatory laws;  
(ii) to monitor compliance with the money laundering regulations; and to perform any other regulatory or supervisory duties that may be imposed on the Authority by any other law;..."*

3. Section 6(3) of the MAL provides that in performing its regulatory functions, the Authority shall, *inter alia* -
  - (a) *endeavour to promote and enhance market confidence and the reputation of the Islands as a financial centre;*
  - (b) *endeavour to reduce the possibility of financial services business or relevant financial business being used for the purpose of money laundering or other crime;*
  - (...)
4. The proposed amendments to the GNs bolster the Authority's effectiveness in the exercise of its regulatory functions. In addition, the amendments will improve market confidence and the reputation of the Islands as a financial centre by reducing the possibility of financial services business being used for purposes of the money laundering, terrorist financing and proliferation financing.
5. Additional information for the purpose of the proposed amendments/addition is found in Section C of this Private Sector Consultation Paper ("PSCP").

### **C. Proposed Amendments to Guidance Notes**

<b>Part 1: Proposed Amendments to "Assessing Risks and Applying a Risk-Based Approach"</b>
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#### **Background**

1. Among the deficiencies highlighted in the MER was the lack of effective implementation of FATF<sup>1</sup> Recommendation 1 on assessing risks and applying a risk-based approach.
2. The jurisdiction received a rating of partially compliant due the following factors, amongst others:
  - (a) Legal persons largely fell outside the scope of consideration. This impacts their ability to fully assess and understand their risk; and
  - (b) The allocations of resources and implementation of measures are being applied on an ad hoc basis, and not on a risk basis.
3. It is against this background that the revisions are being proposed to Part II, Section 3 (Assessing Risks and Applying a Risk Based Approach) of the GNs to remedy some of the shortcomings identified in relation to Recommendation 1. The Authority expects that Part II, Section 3 (Assessing Risks and Applying a Risk

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<sup>1</sup> The Financial Action Task Force (FATF) is an inter-governmental policymaking body whose purpose is to establish international standards, and to develop and promote policies, both at national and international levels, to combat money laundering and the financing of terrorism.

Based Approach) of the GNs will be repealed and replaced by the attached Appendix A in the first quarter of 2020.

**Purpose of Measure**

1. The *FATF’s Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems* requires:

*“Financial institutions and Designated Non-Financial Business and Persons (DNFBPs) when conducting a risk assessment to, take appropriate steps to identify, assess, and understand their money laundering and terrorist financing (ML/TF) risks (for customers, countries or geographic areas; and products, services, transactions or delivery channels) This includes being required to:*

- (a) document their risk assessments;*
- (b) consider all relevant risk factors before determining what is the level of overall risk and the appropriate level and type of mitigation to be applied;*
- (c) keep these assessments up to date; and*
- (d) have appropriate mechanisms to provide risk assessment information to competent authorities and SRBs.”*

2. Additionally, financial institutions and DNFBPs when mitigating risks, should be required to:

- (a) have policies, controls and procedures, which are approved by senior management, to enable them to manage and mitigate the risks that have been identified (either by the country or by the financial institution or DNFBP);
- (b) monitor the implementation of those controls and to enhance them if necessary; and
- (c) take enhanced measures to manage and mitigate the risks where higher risks are identified.

3. The revisions proposed are mainly for the purpose of expanding certain sub-sections which fall under Part II- Section 3 (*Assessing Risks and Applying a Risk-Based Approach*) of the GNs as documented in **Table 1**. The revisions are based primarily on the requirements of Recommendation 1 and (IO) 1.

**Table 1 – Proposed Revisions to Part II, Section 3 of the GNs**

<b>Section</b>	<b>Proposed Revisions</b>
<b>The Risk-Based Approach</b>	This section was updated to reflect additional factors for financial services providers (FSPs) to consider when conducting their risk assessments and outlines the requirements for the categorisation of risks by FSPs.
<b>Identification and Assessment of Risks</b>	This section provides additional factors which ought to be considered by FSPs when ‘weighting risk’.
<b>Risk Classification Factors</b>	This section outlines each of the risk classification factors: customers; countries/geographic areas; and, products, services, transactions or delivery channels. Each classification factor outlines the expectations regarding the

<b>Section</b>	<b>Proposed Revisions</b>
	<p>assignment of higher and lower risk profiles.</p> <p>During the review, additional factors have been documented for FSPs to consider when assessing a customer's risks, a customer's business, reputation and nature and behaviour.</p> <p>The section further reflects:</p> <ul style="list-style-type: none"> <li>- examples of higher and lower risk factors that may be included in the FSP's assessment;</li> <li>- risk factors associated with country/geographic risks, including the factors considered for higher and lower risk classifications; and</li> <li>- risk factors associated with product, services and delivery/distribution channels, including the factors considered for higher and lower risk classifications.</li> </ul> <p>The use of the Anti-Money Laundering Steering Group's List of Equivalent Jurisdictions to indicate lower risk for country/geographic areas has been removed from this section as the list will be discontinued shortly.</p>
<b>Emerging risks (new section)</b>	This section requires FSPs to have systems and controls in place to cater to emerging risks.
<b>Review of Risk (new section) Assessment</b>	This section requires FSPs to have regular review and approval of risk assessments.

**Part 2: Proposed Amendments regarding Ongoing Monitoring.**

**Background**

1. The Authority reviewed the subsection relating to ongoing monitoring and concluded that the guidance was high level and that industry would benefit from having more detailed explanations. It was noted that the guidance heavily focused on monitoring of customer information and documentation, and more attention was needed with regard to the Authority's expectations surrounding transactions monitoring.
2. Recommendation 10 of the FATF 40 Recommendations highlights that financial institutions should be required to ensure that documents, data or information collected under the customer due diligence process is kept up-to-date and relevant by undertaking reviews of existing records, particularly for higher-risk categories of customers<sup>2</sup>.
3. Financial institutions should examine, as far as reasonably possible, the background and purpose of all complex, unusual large transactions, and all

<sup>2</sup> *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*, Financial Action Task Force, June 2019.

unusual patterns of transactions, which have no apparent economic or lawful purpose. Where the risks of money laundering or terrorist financing are higher, financial institutions should be required to conduct enhanced customer due diligence (“CDD”) measures, consistent with the risks identified. FSPs should increase the degree and nature of monitoring of the business relationship, in order to determine whether those transactions or activities appear unusual or suspicious<sup>3</sup>.

4. The proposed amendment for ongoing monitoring (attached as **Appendix B**) is an expansion of subsection H in Part II, Section 4 of the GNs, which upon finalisation will supersede that subsection and be included as a new section in Part II of the GNs.

### **Purpose of Proposed Measure**

1. The Anti-Money Laundering Regulations (“AMLRs”) outline that the requirements of a person carrying out relevant financial business in relation to the systems and training to prevent money laundering and the obligation to identify its customers.

3. Regulation 5(a)(ix) of the AMLRs requires that:

*"A person carrying out relevant financial business shall not, in the course of the relevant financial business carried out by the person in or from the Islands, form a business relationship, or carry out a one-off transaction, with or for another person unless that person –*

*(a) maintains as appropriate, having regard to the money laundering and terrorist financing risks and the size of that business, the following procedures in relation to that business –*

*(ix) such other procedures of internal control, including an appropriate effective risk-based independent audit function and communication as may be appropriate for the ongoing monitoring of business relationships or one-off transactions for the purpose of forestalling and preventing money laundering and terrorist financing;"*

4. Regulation 12(1)(e) of the AMLRs requires that:

*"A person carrying out relevant business shall –*

*(e) conduct ongoing due diligence on a business relationship including –*

*(i) scrutinising transactions undertaken throughout the course of the business relationship to ensure that transactions being conducted are consistent with the person’s knowledge of the customer, the customer’s business and risk profile, including where necessary, the customer’s source of funds; and*

*(ii) ensuring that documents, data or information collected under the customer due diligence process is kept current and relevant to customer due diligence, by reviewing existing records at appropriate times, taking into*

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<sup>3</sup> Ibid

*account whether and when customer due diligence measures have been previously undertaken, particularly for higher risk categories of customers.”*

5. The requirements outlined in Regulations 5 and 12 support the intention of the revised proposals to provide further guidance to FSPs in relation to ongoing monitoring.
6. Recommendation 10 of the Financial Action Task Force’s (“FATF”) 40 Recommendations highlights that financial institutions should be required to ensure that documents, data or information collected under the customer due diligence process is kept up-to-date and relevant by undertaking reviews of existing records, particularly for higher-risk categories of customers<sup>4</sup>. Financial institutions should examine, as far as reasonably possible, the background and purpose of all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or lawful purpose. Where the risks of money laundering or terrorist financing are higher, financial institutions should be required to conduct enhanced CDD measures, consistent with the risks identified. FSPs should increase the degree and nature of monitoring of the business relationship, in order to determine whether those transactions or activities appear unusual or suspicious<sup>5</sup>.

### **Part 3: Proposed addition regarding Virtual Asset Service Providers.**

#### **Background**

1. In June 2019, Schedule 6 of the Proceeds of Crime Law (2017 Revision) (“POCL”) was amended with regards to the activities falling within the Definition of “Relevant Financial Business” to cover VA and VASPs. In addition, in the Proceeds of Crime (Amendment) Law 2019, “virtual asset” means “a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes”; and “virtual asset service” means “the business of conducting one or more of the following activities or operations for or on behalf of a person: (a) exchanging between virtual assets and fiat currencies; (b) exchanging between one or more other forms of convertible virtual assets; (c) transferring virtual assets; (d) safekeeping or administering virtual assets or instruments enabling control over virtual assets; and (e) participating in and providing financial services related to an issuer’s offer or sale of a virtual asset.”
2. The FATF Recommendation 15 requires that countries and financial institutions identify and assess the money laundering and terrorist financing risks that may arise in relation to the development of new products and new business practices, including new delivery mechanisms, and the use of new or developing technologies for both new and pre-existing products. In addition, financial institutions should be required to undertake risk assessments prior to the launch or use of such products, practices and technologies and take the appropriate measures to manage and mitigate the risks. The Cayman Islands received a technical rating of “Largely Compliant” in the MER. In June 2019, FATF added the

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<sup>4</sup> Financial Action Task Force. *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*. (June 2019)

<sup>5</sup> Financial Action Task Force. *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*. (June 2019)

Interpretive Note to Recommendation 15 (“IN-R.15”) which sets out the application of the FATF Recommendations to virtual asset activities and service providers.

3. The proposed addition to the GNs regarding VASPs is attached as **Appendix C**.

### **Purpose of Proposed Measure**

1. The proposed addition to the GNs seeks to assist FSPs in understanding their obligations relating to AML/CFT when acting as VASPs. The FATF VA Guidance and the IN-R. 15 (where appropriate) were considered during the drafting of the proposed amendments to the GNs. The addition covers:
  - (a) Customer due diligence;
  - (b) Record-keeping;
  - (c) Politically exposed persons;
  - (d) Correspondent banking;
  - (e) Money or value transfer services;
  - (f) New technologies;
  - (g) Wire transfers;
  - (h) Reliance on third parties;
  - (i) Internal controls and foreign branches and subsidiaries;
  - (j) Higher-risk countries;
  - (k) Reporting of suspicious transaction; and
  - (l) Tipping-off and confidentiality.
2. The AMLRs came into force on 2<sup>nd</sup> October 2017. Regulation 9 requires that persons carrying out relevant financial business in respect of a) new products and business practices; b) new delivery mechanisms; and c) new or developing technologies, conduct a risk assessment prior to launch or use and to take measures to manage and mitigate such risks. Regulation 5<sup>6</sup> of the AMLRs was amended in July 2019 to require that relevant financial business shall not form a business relationship or carry out a one-off transaction with or for another person unless that person also maintains procedures for preventing, countering, and reporting proliferation financing. In 2020, the AMLR Working Group will be considering further amendments in relation to VA and VASPs to incorporate Interpretive Note to Recommendation 15.

### **D. Implementation of the Proposed GN Amendments in Other Jurisdictions**

1. Financial services regulators in comparable jurisdictions have issued guidance to regulated entities to FSPs on ongoing monitoring and on assessing risks and applying the risk-based approach. In drafting the proposed amendments to the GNs on ongoing monitoring, the Authority considered guidance issued by the Jersey Financial Services Commission, Isle of Man Financial Services Authority, and the Central Bank of Ireland. Guidance on assessing risks and applying the risk-based approach were assessed from Isle of Man, Bermuda, Australia, Canada and Ireland.

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<sup>6</sup> Regulation 5 is “Systems and training to prevent money laundering” under Part II – Compliance Programmes, Systems and Training Obligations of the AMLRs (2018 Revision).



2. **Table 2** summarises the findings in relation to the revised guidance relating to ongoing monitoring as noted in other jurisdictions; **Table 3** summaries the findings regarding assessing risk and applying the risk-based approach.
3. Financial services regulators have issued guidance to

**Table 2: Jurisdictional Comparison - Ongoing Monitoring**

Content	Isle of Man	Jersey	Ireland	Cayman Islands (proposed)
Overview of ongoing monitoring	X	X	X	X
Ongoing monitoring of customer information	X	X	X	X
Ongoing monitoring of customer transactions/ account activity	X	X	X	X
Requirement for documented policies and procedures for ongoing monitoring	X	X	X	X
Requirement for periodic review of customer files	X	X	X	X
Periodic customer screening	X		X	X

**Table 3: Jurisdictional Comparison – Assessing Risks and Applying a Risk-Based Approach**

Content	Isle of Man	Bermuda	Australia	Canada	Ireland	Cayman Islands (Proposed)
The Risk-Based Approach	X	X	X	X	X	X
Identification and Assessment of Risks	X	X	X	X	X	X
Risk Classification Factors	X	X	X	X	X	X
Emerging Risks		X	<sup>7</sup>	X	X	X
Review of Risk Assessment	X	X	X <sup>8</sup>	X	X	X

4. The Authority did not review guidance issued by other jurisdictions to regulated entities regarding VA and VASPs as jurisdictions have 18 months for

<sup>7</sup> Not seen in available information reviewed.

<sup>8</sup> Required to be independent.

implementation. The proposed amendments to the GNs were drafted based on the FATF VA Guidance and the IN-R. 15. **Table 4** provides a summary of guidance for preventive measures (R. 10 – R. 21) and indicates whether the relevant recommendations are included in the draft amendment.

**Table 4: Summary of FATF Recommendations - VASPs**

<b>FATF Recommendation</b>	<b>Included in the Proposed Guidance</b>
Recommendation 10: Customer due diligence	X
Recommendation 11: Record-keeping	X
Recommendation 12: Politically exposed persons	X
Recommendation 13: Correspondent Banking	X <sup>9</sup>
Recommendation 14: Money or value transfer services	X
Recommendation 15: New technologies	X
Recommendation 16: Wire transfers	X
Recommendation 17: Reliance on third parties	X <sup>10</sup>
Recommendation 18: Internal controls and foreign branches and subsidiaries	X
Recommendation 19: Higher-risk countries	X
Recommendation 20: Reporting of suspicious transaction	X
Recommendation 21: Tipping-off and confidentiality	X

**E. Significant Costs and Benefits**

1. **Table 5** shows the estimated costs and benefits of the proposed amendments to the GNs.
2. The intention of the guidance for ongoing monitoring and risk-based approach is intended to expand on the current criteria in the GNs, giving FSPs further clarity on the Authority’s expectations. The guidance on VA and VASPs could lead to the implementation of new systems, policies and procedures given this is considered relevant financial business under the AMLRs.

<sup>9</sup> The proposed amended GNs does not specifically address correspondent banking in the VASP sector however the proposed GNs states that all financial service providers (including VASPs) are expected to take account of the guidance notes and fully comply with the obligations set out in the POCL and the AMLRs when providing virtual asset services. The issue of correspondent banking and the relevant financial business is addressed in Part XI of the AMLRs and Part II of the GNs.

<sup>10</sup> The proposed amended GN does not specifically address reliance on third parties in the VASP sector however the proposed GN states that all financial service providers (including VASPs) are expected to take account of the guidance notes and fully comply with the obligations set out in the POCL and the AMLRs when providing virtual asset services.

**Table 5 – Estimated Costs and Benefits of Proposed Amendments**

	<b>Costs</b>	<b>Benefits</b>
<b><i>CIMA</i></b>	<ol style="list-style-type: none"> <li>1. Processing amendments and conducting consultation.</li> <li>2. Staff training.</li> <li>3. Conducting outreach to FSPs.</li> <li>4. Responding to FSP queries.</li> <li>5. Additional costs of monitoring compliance with new guidance.</li> </ol>	<ol style="list-style-type: none"> <li>1. More clarity during onsite inspections, resulting in more consistency between regulated entities and more streamlined inspections and reports.</li> <li>2. Savings of time when compared to responding to queries from individual institutions about their obligations.</li> </ol>
<b><i>Cayman Islands</i></b>	<ol style="list-style-type: none"> <li>1. There are no foreseen costs to the jurisdiction with regards to the revisions to Part II, Section 3 (Assessing Risks and Applying a Risk-Based Approach) of the GNs., and the Ongoing Monitoring Amendment.</li> <li>2. Gazettal of the amendments upon approval.</li> <li>3. There will be costs associated with VASPs establishing a compliance programme. There is potential for VASPs currently in the Islands to exit the jurisdiction instead of complying with the amended GNs.</li> </ol>	<ol style="list-style-type: none"> <li>1. Increases the reputation of the jurisdiction, which may lead to more business being done in the Islands.</li> <li>2. Enhances compliance of the jurisdiction with FATF Standards, specifically with Recommendations 1, 10 and 15 thereby reducing likelihood of appearing on blacklists and related consequences of blacklisting.</li> <li>3. Jurisdiction will be better equipped for February 2020 CFATF Follow-up.</li> </ol>
<b><i>Regulated Entities</i></b>	<ol style="list-style-type: none"> <li>1. Staff training on the revisions</li> <li>2. FSPs may also incur additional costs associated with updating and reviewing their current risk assessment framework to ensure compliance with the</li> </ol>	<ol style="list-style-type: none"> <li>1. Reduces risk of regulated entity being used to facilitate financial crime, which could jeopardize the VASPs reputation and potentially its ability to carry on business.</li> </ol>

	<b>Costs</b>	<b>Benefits</b>
	<p>amended GNs.</p> <p>3. No additional costs regarding ongoing monitoring, as entities would have considerably implemented monitoring programmes to comply with the AMLRs.</p> <p>4. Implementation of new systems and controls for VASPs.</p> <p>5. Implementation of new forms, policies and procedures for VASPs, including KYC/CDD forms.</p> <p>6. Time and cost to build expertise on the FATF Recommendations for VASPs.</p> <p>7. The costs for the VASPs to conduct due diligence on persons and entities. This cost depends on the number of such persons and entities.</p>	<p>2. Improved risk management and information on customers could prevent institution from being used to commit financial crime.</p>

3. Given the hidden nature of ML/TF and PF, estimating all the costs and benefits of the proposed amendments is challenging. VASPs will have to bear the cost of initial setup of systems and policies to meet the requirements of the GNs, therefore the initial costs of implementing the guidance could be significant. However, most of the costs are one-time costs. The jurisdiction faces potentially very severe risks if the guidance is not implemented thus the benefits and avoidance of risks for the jurisdiction outweigh the costs involved.

**F. Comments and Consultation**

1. The Authority seeks consultation through written comments and representations from the private sector associations concerning the amendments to the Guidance Notes on the Prevention and Detection of Money Laundering in the Cayman Islands. The Authority must receive representations by 1700hrs on **Friday, January 10<sup>th</sup>, 2020.**

2. Comments and representations must be addressed to:
- 3.

The Managing Director  
Cayman Islands Monetary Authority  
P.O. Box 10052  
SIX, Cricket Square  
Grand Cayman KY1-1001  
Cayman Islands  
Tel: 345-949-7089  
Fax: 345-946-5611  
Email:  
[Consultation@cima.ky](mailto:Consultation@cima.ky)  
[and copied to ShannonFrancis@cima.ky](mailto:ShannonFrancis@cima.ky)

4. The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.