



**GUIDANCE NOTES ON THE PREVENTION AND DETECTION OF  
MONEY LAUNDERING AND TERRORIST FINANCING  
IN THE CAYMAN ISLANDS**

**PART VIII**

**SECURITIES INVESTMENT BUSINESS  
SECTOR SPECIFIC AML/CFT GUIDANCE NOTES**

This purpose of Part VIII of the Guidance Notes is to deal with AML / CFT matters pertaining to Securities Investment Businesses that require more explanation or are more complex issues than are dealt with in the general body of these Guidance Notes. This section must be read in conjunction with Part I and II of the Guidance Notes and the Appendices.

## SECTION 1

### SECURITIES INVESTMENT BUSINESSES ("SIBs")

#### A. OVERVIEW

1. Schedule 1 of the Securities Investment Business Law (2015 revision) ("SIBL") defines securities as:
  - (1) shares, or stock of any kind in the share capital of a company;
  - (2) debentures, loan stock, bonds certificates of deposit and any other instrument that creates or acknowledges debt (excluding various banking and monetary instruments e.g. cheques, mortgage instruments and land charges);
  - (3) warrants and other instruments which confer contractual or property rights;
  - (4) options on any security and on any currency, precious metal or an option on an option;
  - (5) futures, and
  - (6) rights under contracts for differences (e.g. cash-settled derivatives such as interest rate and stock index futures, forward rate agreements and swaps).
2. The SIBL provides for the regulation of persons carrying on securities investment business, including the regulated activities of market makers, broker-dealers, securities arrangers, securities advisors and securities managers, in or from the Cayman Islands.
3. Pursuant to the SIBL, persons engaged in securities investment business must hold a Securities Investment Business Licence, unless he is a person specified under the provisions set out in Schedule 4 of the SIBL who do not require a licence to conduct securities investment business.
4. Under the SIBL, the Monetary Authority is directly responsible for licensing, and for supervision and enforcement in respect of licensees. It is also responsible for the investigation of persons where it believes that they are, or have been undertaking securities investment business without a licence or an exemption as an Excluded Person under Section 5(2) and Schedule 4 of the SIBL to do so.
5. The Monetary Authority regulates securities investment business in accordance with:
  - (1) the SIBL and its regulations, namely:
    - (a) The Securities Investment Business (Licence Applications and Fees) Regulations, 2003;
    - (b) The Securities Investment Business (Conduct of Business) Regulations, 2003; and
    - (c) The Securities Investment Business (Financial Requirements and Standards) Regulations, 2003;
  - (2) the relevant rules, guidance, policies and procedures issued by CIMA; and

- (3) international supervisory standards issued by the International Organisation of Securities Commissions ("IOSCO").
6. The Monetary Authority's powers and duties are more particularly set out in sections 16 and 17 of the SIBL. Under Section 18, the Monetary Authority can apply to the Grand Court for injunctions and restitution and disgorgement orders.

## **B. SCOPE**

1. The sector specific guidance contained in this section is applicable to persons carrying on "securities investment business" ("SIB") as defined in the POCL wherein SIB has the meaning assigned in the SIBL. Although not required to be licensed, persons specified in Schedule 4 of the SIBL are considered to be carrying on SIB and therefore required to comply with the AMLRs and POCL. Parts I and II and this Part (VII) of the Guidance Notes are therefore applicable to persons licensed under the SIBL and to persons specified in Schedule 4 of SIBL.

## **C. MONEY LAUNDERING AND TERRORIST FINANCING RISKS**

1. Securities investment business activities carry a certain degree of ML/TF risks due to having exposure to factors including but not limited to:

### **Products and services:**

- (1) Securities arranging and advising may be deemed less risky than broker dealers, market makers and investment managers because a securities advisor may not be directly involved with the exchange of funds from their clients; and a securities arranger may bring two parties together to facilitate a transaction only.
- (2) At times, particular activities may not involve face to face identity verification as for example phone calls to place trades may be executed by a securities investment business and/or access to remotely execute such trades may occur although identity theft, cybersecurity and pretexting may be prevalent in such circumstances.
- (3) Other factors for consideration with products can be based on the complexity, liquidity, volume and value of products being bought or sold on behalf of clients. Are there ethical agreements for discretionary trading accounts between clients and security investment businesses? Are third party deposits accepted? Are credit cards accepted for payment?
- (4) Full due diligence should be conducted for all parties that have outsourcing responsibilities for registered and/or licensed securities investment businesses and should be monitored on a regular basis.

### **Country Risk**

- (5) Having clients located in multiple international locations can increase the risk of money laundering and terrorist financing.

- (6) Security investment businesses should be especially careful when dealing with investors who are PEPs of a foreign jurisdiction or those from a country on a sanctions list.
- (7) Customers based in/controlled or owned by persons based in high risk jurisdictions should also be particularly monitored.

#### **Customer Type/Investor Profile**

- (8) In addition to the country of domicile of clients, the types of individuals/entities that make up the client base can also increase the risk of money laundering and terrorist financing.
- (9) All things being equal, institutional clients from large financial institutions that are regulated and/or listed on a stock exchange could be considered less risky than investors in the form of companies and trusts with complex structures, PEPs, charities or high net worth individuals for example.
- (10) Smaller institutions may have less awareness/insufficient staff to deal with potential "red flags" and/or ML/TF issues.

#### **Source of Funds/Transparency**

- (11) Investments with higher return rates such as equities, derivatives and options pose a greater risk of money laundering, especially if those trades are not coming from a regulated financial institution/trading platform – i.e. OTC – or a regulated jurisdiction.
- (12) Securities investment businesses must remain cognizant of, and have controls in place surrounding, types of trading activities in discretionary accounts, locations of funds and understand the risks posed by allowing such trading on their accounts.

#### **Market Manipulation**

- (13) Market manipulation – tactics can be undertaken if securities investment businesses do not highly monitor the trading activities of their clients. For example, commission based trading may lead to conflicts of interest/churning tactics.

### **D. RISK BASED APPROACH** (refer also to section 3 of Part II)

1. FSPs carrying on Securities Investment Business are required to adopt a risk-based approach to managing ML and TF risks as set out in the AMLRs and in section 3 of Part II of these Guidance Notes.
2. SIBS should pay particular attention to risk assessment factors and risk variables that are in addition to those in Part II Section 3 or which present higher risks or greater inherent risks for SIBs. Such factors and variables may include the ML/TF risk included in Section C above, the warning signs included in Section I below and other customer, product, service, transaction or delivery issues contained in these (Part VII) SSGs.

## E. SYSTEMS, POLICIES & PROCEDURES

### Who is the applicant for business?

#### 1. The applicant for business may be one of the following:

<b>Where the <i>Financial Services Provider</i></b>	<b>Applicant for Business is</b>
acts as agent in buying, selling, managing, subscribing for or underwriting securities	the principal
acts as principal or makes arrangements in buying, selling, managing, subscribing for or underwriting securities	the counterparties
advises an investor or potential investor on the merits for buying, selling, managing subscribing for or underwriting securities	the investor or potential investor

### Customer Due Diligence (refer also to section 4 of Part II)

#### When must the identity be verified?

2. The Regulations provide that there should be procedures in place requiring, as soon as reasonably practicable after contact is first made with an applicant for business, either satisfactory evidence of the applicant's identity or that steps are taken which will produce satisfactory evidence of identity.
3. The time span in which satisfactory evidence has to be obtained depends on the particular circumstances and the practicalities of obtaining evidence before commitments are entered into between parties and before money passes.

#### How might identification of existing clients be carried out?

4. Refer to section 4 of Part II of these Guidance Notes.
5. If, after having conducted a risk assessment in accordance with section 4 of Part II of the Guidance Notes, verification procedures or identification of an investor have not been completed prior to the date on which a redemption is to take place, the Securities Investment Business should use the opportunity of the redemption to seek satisfactory evidence of identity.

6. Payment of the redemption proceeds should be made only to the investor and not to a third party and only when the outstanding due diligence documentation has been collected and verified.
7. If payment has been made from an account in the name of the investor with a regulated bank in the Cayman Islands or in an AMLSG List country and the criteria set out in section 4 of Part II of these Guidance Notes are adhered to, that will be sufficient evidence of identity.
8. It is important to note that the above scenarios are only permissible in circumstances where simplified due diligence is permissible.

### **Particular issues on Verification of identity of investors**

#### One-off transactions.

9. Refer to section 4 of Part II of these Guidance Notes.

#### Payment on an Account in a Bank in the Cayman Islands or an AMLSG List country

10. Refer to section 4 of Part II of these Guidance Notes.

#### Enhanced Due Diligence

11. SIBs should carry out EDD in situations as stipulated in the ALMRs and or in Part II of these GNs and or where the SIB has identified or assessed that it is exposed to high ML/ FT risks. Examples of where EDD may be required include categories of customers specified in Section 4 of Part II of these Guidance Notes such as Associations, Not for Profit (Including Charities), Politically Exposed Persons (PEPs), and those from High-Risk Countries.
12. Additional examples would include cases in which a client is confidentiality-driven, or presents a multi-layered structure of beneficial ownership for no apparent business reason, or when "red flags" are noticed.

#### Information that should be obtained in relation to the proposed transaction, business and source of assets in addition to that listed in the Guidance Notes.

13. Where the principal, counterparty(ies), or investor or potential investor is a natural person, sufficient information should be collected to anticipate normal business activity, including type of products required and general level of likely activity and investment goals.
14. Where the principal, counterparty(ies), or investor or potential investor is a legal person or legal arrangement, in addition to the information needed to establish normal business activity, sufficient information regarding intra-group relationships, if any; clients; service providers; and trading partners should also

be collected to establish a trading profile which can be monitored against transactions.

### **Internal Controls and Ongoing Monitoring**

15. For each investment transaction, the Securities Investment Business should record the information required under section 8 of Part II of these Guidance Notes. In addition, the Securities Investment Business should consider whether the transaction is consistent with the client profile and client's stated investment goals and expectations, and should also be alert to the "red flags" listed below.
16. Securities Investment Businesses must have internal reporting procedures in place to (1) identify and report suspicious activity, (2) monitor and ensure internal compliance with laws relating to money laundering, and (3) test the AML/CFT system consistent with the Regulations and the Guidance Notes ("Procedures"). Although ultimate responsibility for maintaining and implementing satisfactory Procedures remains with the Securities Investment Businesses, the obligations may be met by delegating or outsourcing those functions.
17. A Securities Investment Business may delegate any of the Procedures to a regulated person in the Cayman Islands or a person in an AMLSG List country that is subject to the AML/CFT regime of that country, consistent with the requirements of section 4 of Part II of these Guidance Notes, where applicable. The Securities Investment Business will be regarded by the Monetary Authority as being compliant with the Regulations and the Guidance Notes with respect to the Procedures if the delegate complies with the Procedures of such jurisdiction.
18. A Securities Investment Business may also delegate any or all of its obligations with respect to the maintenance of Procedures to a suitable third party or parties, whether within or outside the Cayman Islands, provided that such appointment is consistent with the requirements of section 4 Part II of these Guidance Notes, where applicable.
19. The operators of the Securities Investment Business should document, either as a board resolution or otherwise, the manner in which the entity has met its obligation to maintain Procedures.

### **Record Keeping**

#### **What specific records should be kept and where?**

20. Refer to section 8 and 11 of Part II of these Guidance Notes.

#### **When may a successor Securities Investment Business Rely on the client verification evidence obtained by its predecessor?**

21. Where a successor firm is acquiring existing Securities Investment Business, the successor must ensure that the necessary due diligence has been

performed prior to performing the additional transactions. It may be possible to rely upon the evidence of identity obtained by a predecessor Securities Investment Business provided that the original files, or certified copies of the original files, are transferred to the successor Securities Investment Business and the successor firm has assessed the quality of the evidence on investor identity. Where insufficient evidence exists, it may be appropriate to supplement with additional evidence to meet the standards required by these Guidance Notes.

22. At no time would it be appropriate to rely upon third parties, such as eligible introducers.

## **F. MT/TF WARNING SIGNS**

1. It should be acknowledged that although the presence of any of the below-referenced behaviours does not necessarily indicate an inappropriate or illegal act, the Securities Investment Business should make enquiries and be satisfied with any explanations provided especially as more and more of these activities are present.
  - (1) Some of the warning signs are as follows:
    - (a) clients who are unknown to the securities investment business and verification of identity / incorporation proves difficult;
    - (b) clients who wish to deal on a large scale but are completely unknown to the securities investment business;
    - (c) clients who wish to invest or settle using cash;
    - (d) clients who use a cheque that has been drawn on an account other than their own;
    - (e) clients who change the settlement details at the last moment;
    - (f) clients who insist on entering into financial commitments that appear to be considerably beyond their means;
    - (g) clients who accept relatively uneconomic terms, when with a little effort they could have a much better deal;
    - (h) clients who have no obvious reason for using the services of the Securities Investment Business (e.g.: clients with distant addresses who could find the same service nearer their home base; clients whose requirements are not in the normal pattern of the service provider's business which could be more easily serviced elsewhere);
    - (i) clients who refuse to explain why they wish to make an investment that has no obvious purpose;
    - (j) clients who are introduced by an overseas agent based in a country noted for drug trafficking or distribution or a client introduced by an overseas branch, affiliate or other service provider based in non-AMLSG List country;

- (k) clients who transfer funds or shares to accounts in a non- in an AMLSG List country;
  - (l) clients who indulge in much activity with little or no profit over a number of jurisdictions;
  - (m) clients who carry out large numbers of transactions with the same counterparty in small amounts of the same security, each purchased for cash and then sold in one transaction, particularly if the proceeds are also then credited to an account different from the original account;
  - (n) clients who purchase low grade securities in an overseas jurisdiction, sell locally and then purchase high grade securities with the proceeds;
  - (o) clients who constantly pay-in or deposit cash to cover requests for bankers drafts, money transfers or other negotiable and readily marketable money instruments;
  - (p) clients who wish to maintain a number of trustee or clients' accounts which do not appear consistent with the type of business, including transactions which involve nominee names;
  - (q) any transaction involving an undisclosed party;
  - (r) transfer of the benefit of an asset to an apparently unrelated third party, or assignment of such benefit as collateral;
  - (s) significant variation in the pattern of investment without reasonable or acceptable explanation.
- (2) Securities investment businesses also need to be aware that their employees could be targeted by money launderers and therefore should be aware of:
- (a) changes in employee characteristics (eg: lavish life styles or avoiding taking holidays), and
  - (b) changes in employee or agent performance, (eg: a dealer has remarkable or unexpected increase in performance).