

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
SECURITIZATION**

A. Introduction

1. Section 34(1)(c) of the Monetary Authority Law (2018 Revision) (as amended) ("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. 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.”

3. The Cayman Islands Monetary Authority (“the Authority”) seeks consultation and comment from the private sector associations concerning the 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”) relating to Securitization (attached as Appendix A).

B. Background

4. Since 2018, the Authority has received queries regarding the applicability of the GNs to securitization vehicles. The proposed amendments to the GNs seek to provide clarity to the private sector on the applicability of the GNs to securitization vehicles and any AML/CFT obligations relating to such vehicles.
5. Schedule 6 of the Proceeds of Crime Law lists the types of business that are relevant financial businesses and that as a result must comply with the Anti-Money Laundering Regulations (“AMLRs”). Schedule 6 reflects the list of types of entities that the FATF requires be subject to frameworks against money laundering (“MF”) and terrorist financing (“TF”). While Schedule 6 does not directly mention securitization vehicles, it does include within the scope of relevant financial business:
 - (1) Participation in securities issues;
 - (2) Financial (...) services provided in the course of business relating to (d) the creation, operation or management of legal persons or arrangements; and
 - (3) Otherwise investing, administering or managing funds or money on behalf of other persons.
6. As such, even though the Authority does not directly regulate securitization vehicles under the Regulatory Laws, given that securitization vehicles are relevant financial business under the AMLRs, section 34(1)(b) of the Monetary Authority Law allows the Authority to provide clarity to the private sector on the applicability of the GNs to securitization vehicles.
7. The proposed amendments do not create new obligations for relevant financial businesses, as the definition of “relevant financial business” is codified in the Proceeds of Crime Law and the obligations of relevant financial businesses are outlined in the AMLRs. Rather, they clarify how these entities should meet their obligations under the existing legislation.

C. International Standards

8. In December 2017, the Caribbean Financial Action Task Force (“CFATF”) assessed 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.

9. While there was no mention of securitization vehicles in the MER, the FATF recommendations require countries to subject financial services providers (“FSPs”) to the FATF AML/CFT framework. Included in this list of FSPs are:
 - (1) Lawyers;
 - (2) Trusts and company services providers;
 - (3) Entities that participate in securities issues; and
 - (4) Entities that provide safekeeping and administration of cash or liquid securities.
10. Special Purpose Vehicles (“SPVs”) involving securitizations are encompassed in the list in paragraph 9, as are other service providers to securitization vehicles. The Authority is therefore seeking to provide specific guidance on how Cayman Islands established securitization vehicles should comply with the AML/CFT regulatory framework.

D. Purpose of Proposed Measure and Consistency with the Authority’s Functions

11. Section 6(1)(b) of the MAL establishes the responsibilities of the Authority with respect to its regulatory functions, namely:
 - (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*
 - (iii) to perform any other regulatory or supervisory duties that may be imposed on the Authority by any other law;*
12. 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;*
 - (...)*
13. The proposed addition to the GNs seeks to provide clarity to the private sector on the applicability of the GNs to securitization vehicles and any AML/CFT obligations relating to such vehicles. The proposed addition includes:
 - (1) A definition and general discussion of the concepts surrounding the application of AML/CFT measures to securitization vehicles;
 - (2) The ML, TF and proliferation financing (“PF”) risks associated with SPVs and the requirement for SPVs to apply a risk-based approach to assessing these risks;

- (3) Guidance on customer due diligence procedures to be implemented by SPVs, to address particular issues on verification of identity of investors and the implementation of internal controls as prescribed by the AMLRs;
 - (4) Recommended procedures on the management of records; and
 - (5) Warning signs to be cognisant of with regard to ML, TF and PF.
14. In addition, the updated guidance 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 ML, TF and PF.
 15. The proposed amendments to the GNs strengthen the efforts of the Authority to improve its effectiveness in the exercise of its regulatory functions, widening the net under the AML/CFT regime to influence the activities of SPVs.

E. Implementation in Other Jurisdictions

United Kingdom

16. The UK Joint Anti-Money Laundering Steering Group (“JMLSG”) has issued guidance on AML/CFT for securitization transactions. After providing a definition of securitization, the JMLSG states that an FSP must conduct CDD on the following parties to a securitization transaction:
 - (1) The advisor or facilitator for the transaction;
 - (2) The owner of assets; and
 - (3) The counterparty to the transaction.
17. The guidance states that the FSP must satisfy itself of the basic identity information and evidence of the existence of the special purpose vehicle. The FSP should also satisfy itself that the securitization has a legitimate economic purpose.
18. Other obligations of an FSP, such as ongoing monitoring and training, also apply with respect to securitization transactions.

United Nations Office on Drugs and Crime

19. The United Nations Office on Drugs and Crime states that fiduciaries are vulnerable to being used for purposes of financial crimes in the context of securitization. This document lists certain red flags in relation to securitization, as follows:
 - (1) Establishment of fiduciary business for purpose of securitization through goods or assets that the fiduciary has determined have been the object of legal measures or whose present or former owners hold a police record.
 - (2) Assets involved in securitization are difficult to quantify or are in locations difficult to access.
 - (3) Assets involved in securitizations through assets that exhibit legal inconsistencies as refers to their ownership, possession or tenure, that are overvalued or whose characteristics are not in keeping with the sector.

Luxembourg

20. In Luxembourg, which applies the 4th European Union AML Directive, securitization vehicles are in scope of the regulatory framework for ML if they carry out company provider services. All the service providers of securitizations, including agents, auditors, etc. must comply with all aspects of the regulatory framework for AML/CFT in relation to the securitization transaction. FSPs must identify the beneficial owners of the applicants for business and define the risks of the transaction. Applicants for business include, depending on the FSP, the owners of assets to be securitised and the investors.

Ireland

21. The Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Act 2018 requires special purpose entities to register with the Central Bank of Ireland in relation to the oversight of AML/CFT (subject to a de minimis threshold). Entities that provide services to these vehicles, such as those providing services relating to securities issuances and advice to undertakings on structure must also register. All the above entities must comply with the AML/CFT regulatory framework.

F. Significant Costs and Benefits

22. The guidance on securitization clarifies existing requirements imposed by the AMLRs. As such, there should be no new compliance costs for regulated entities, assuming that they are currently in compliance with these regulations.
23. Table 2 shows the estimated costs and benefits of the proposed amendments to the GNs.

Table 2 – Estimated Costs and Benefits of Proposed Amendments

	Costs	Benefits
<i>CIMA</i>	<ol style="list-style-type: none">1. Processing amendments and conducting consultation2. Staff training3. Conducting outreach to FSPs4. Responding to FSP queries	<ol style="list-style-type: none">1. Savings of time when compared to responding to queries from individual institutions about their obligations
<i>Cayman Islands</i>	<ol style="list-style-type: none">1. Increases the cost for SPVs of setting up in the Cayman Islands, which could result in sponsors of securitization transactions to set up in jurisdictions whose legislation exempts SPVs from AML/CFT regulations	<ol style="list-style-type: none">1. Increases the reputation of the jurisdiction, which may lead to more business being done in the Islands.2. Facilitates the investigation and prosecution of offences, as the GNs will improve detection by FSPs

	Costs	Benefits
		3. Enhances compliance of jurisdiction with FATF standards, thereby reducing likelihood of appearing on blacklists and related consequences of blacklisting (including higher compliance costs and exclusion from certain countries and markets)
Regulated Entities	<ol style="list-style-type: none"> 1. Cost for SPVs of conducting AML/CFT risk assessments 2. Costs for FSPs that provide services to SPVs to train staff on how to properly vet securitization transactions 	<ol style="list-style-type: none"> 1. More clarity on obligations will reduce the time FSPs spend on deciding how to deal with clients who are part of a securitization transaction 2. Reduces risk of FSP being used to facilitate financial crime, which could jeopardize the firm's reputation and potentially its ability to carry on business. 3. Clarification on ongoing monitoring may reduce regulatory burden for SPVs

24. Given the hidden nature of ML/TF and PF, the task of estimating costs and benefits of the proposed guidance is challenging. Most AML/CFT monitoring tools/systems currently utilised by most FSPs have the screening capabilities for implementation of these requirements. New costs to be borne would relate mainly to asset freezing and reporting, which are considered to be minimal. The main system costs for new market entrants would be onetime costs. In relation to securitization, FSPs would need to consider the increased cost of applying AML/CFT procedures to SPVs.

25. There are also significant benefits for the jurisdiction if regulated entities implement the guidance and 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 for regulated entities.

G. Comments and Consultation

26. The Authority seeks consultation through written comments and representations from the private sector associations concerning the:

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 - Securitization

27. The Authority must receive representations by 1700hrs on **Friday, September 13, 2019.**
28. Comments and representations must be addressed to:

The Managing Director
Cayman Islands Monetary Authority
P.O. Box 10052
80e Shedden Road
Elizabethan Square
Grand Cayman KY1-1001
Cayman Islands
Tel: 345-949-7089
Fax: 345-946-5611
Email:

consultation@cima.ky
and copied to kourtneigh-michellenicholson@cima.ky

29. 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.