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SECURITIZATION

A. OVERVIEW

1. Securitization is a financing technique that involves the pooling of assets by a sponsor, typically through an off-balance sheet bankruptcy remote special purpose vehicle, which purchases the assets from the sponsor using proceeds of claims issued to investors, usually in the form of debt. This debt is backed by the cash flow generated from the asset pool. Securitization transactions include the issuance of collateralized debt obligations, collateralised loan obligations and asset backed securities, as well as all other similar transactions. The term investor refers to any person or entity purchasing a security issued by the SPV, including a bondholder, noteholder and unitholder.
2. The Cayman Islands has company, trust, partnership and related laws that allow a high degree of flexibility for establishing special purpose vehicles. Because of their structure, securitization vehicles that are not insurance securitization vehicles are generally not required to be regulated or licensed by the Authority under any regulatory law. Regardless, such securitization transactions present ML/TF risks.

B. SCOPE

1. The sector specific guidance contained in this Part is applicable to non-insurance special purpose vehicles ("SPVs"); the parties that provide services to such SPVs, including trustees, law firms, placement agents, clearing systems, asset servicers and administrators; and to securitization originators, arrangers or sellers of assets ("sponsor").
2. SPVs themselves are considered to be relevant financial businesses under the POCL, and as such are required to comply with the AMLRs and the General Guidance provided in these Guidance Notes. In addition, various service providers to the SPVs may also be considered as relevant financial businesses under the POCL.
3. In this section of the guidance, a reference to "SPV" captures only non-insurance securitization vehicle, whereas a reference to "FSP" includes the SPV as well as all its relevant service providers (i.e. those that are relevant financial businesses under the POCL). For guidance for insurance special purpose entities, please see Part V of these Guidance Notes.
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C. MONEY LAUNDERING, PROLIFERATION FINANCING AND TERRORIST FINANCING RISKS

1. As is the case with most financial products, SPVs carry a certain degree of ML/TF risks. Listed below are some, but not all, of these relevant risks.
 - (1) **Country Risk** – having counterparties located in multiple international locations or in high risk countries that have weak AML/CFT regimes can increase the risk of ML/TF.
 - (2) **Counterparty/Investor Profile** – in addition to the country of domicile of investors, the types of individuals/entities that make up the investor base can also increase the risk of ML/TF. All things equal, institutional investors 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 trusts, charities or high net worth individuals for example. SPVs should be especially careful when dealing with investors who are PEPs of a foreign jurisdiction or those from a country on a sanctions list, including targeted financial sanctions relating to proliferation.
 - (3) **Source of Funds** –Administrators/asset servicers must remain cognizant of and have controls in place surrounding the source of subscription funds and the destination of distributions of SPVs.
 - (4) **Source of Assets in the Pool** – The sponsor may procure the assets to be pooled using laundered funds or otherwise have illegitimately obtained the asset.
 - (5) **Terrorist Financing Risk** – On-going cash flows to investors generated by the asset pool can be an attractive source of funds for terrorist financiers. In addition, the sponsor could use the proceeds from the sale of the asset to finance terrorist activities.

D. RISK-BASED APPROACH (refer also to Section 3 of Part II)

1. SPVs should carry out an AML/CFT risk assessment of their overall structure. Given the lack of staff within an SPV, this risk assessment could be conducted by an external AML/CFT party contracted by the SPV. In this risk assessment, SPVs should consider risks arising from the nature and size of their business model, the geographical location of counterparties, the complexity of the transaction, the non-face-to-face basis for subscriptions, distributions and transfers, and types of securitized products that might be more attractive for financial crime.
2. Low and high-risk indicators, including the ML/TF risks outlined in Section C above and the ML/TF warning signs outlined in Section J below, should be considered when conducting risk assessments. SPVs should be aware of, and take into account, additional risk factors or risk variables that may be introduced where services, functions or activities of the SPV are outsourced or delegated, particularly so if the service provider is not subject to adequate AML/CFT laws and measures and/or is not adequately supervised.

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E. **APPLICANT FOR BUSINESS** (refer also section 4 of Part II)

1. In order to forestall financial crime, including ML/TF, it is important to obtain background knowledge about all the participants in a corporate finance transaction, and not just those who are investors. This background gathering exercise should include measures to understand the ownership and control structure of the SPV as well as look at the beneficial ownership and any possible involvement of PEPs, establishing the purpose and intended nature of the business relationship⁸ and whether this is consistent with the transaction being undertaken.
2. An FSP that is the service provider to an SPV, in addition to verifying the identity of the sponsor and its beneficial owners, should satisfy itself that the securitization has a legitimate economic purpose.

Who should be treated as the Applicant for Business?

The applicant for business may be any one of the following:

	FSP	Applicant for Business
1.	The SPV	(1) Investors (through placement agent/arranger)
2.	FSP incorporating a company or otherwise organizing the securitization structure (including providing the registered office)	(1) Sponsor; and (2) Where the SPV is a trust, the trustees; or (3) Where the SPV is a limited partnership, the general partner; or (4) Where the SPV is a corporation, the directors (see the section on Company Formation and Management).
3.	FSP issuing and administering subscriptions/redemptions.	(1) The SPV; and (2) The investors
4.	Share trustee	(1) The SPV; and (2) The beneficiary of any trust holding the shares of the SPV
5.	Note trustee/Indenture trustee	(1) The SPV; and (2) Investors
6.	Placement agent/arranger	(1) Investors
7.	Clearing system	(1) Placement agent/arranger

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F. CUSTOMER DUE DILIGENCE (refer also to Section 4 of Part II)

When must the identity be verified?

1. The AMLRs provide that there should be procedures in place which require that, as soon as reasonably practicable after contact is first made with an applicant for business, either satisfactory evidence of the applicant's identity should be obtained, or that steps are taken which will produce satisfactory evidence of identity.
2. The time span in which satisfactory evidence should be obtained depends on the particular circumstances and the practicalities of obtaining evidence before commitments are entered into between parties and before money is transferred.
3. Customer risk assessments relating to particular investors should take place as an investor is on-boarded and should be reviewed and changed, if necessary, during periodic reviews of the investors as discussed in the Ongoing Monitoring section below. Customers and investors that are risk classified as low (or the equivalent) may be subject to simplified CDD procedures. However, SPVs must be aware that their risk classification of a Customer/Investor being low-risk is only valid if the finding is consistent with the findings of the Authority, or the of national risk assessment, whichever is more recently issued. Customers and investors that are risk classified as medium risk (or the equivalent) may be subject to at least normal CDD procedures. Customers and investors risk classified as high risk must be subject to enhanced CDD procedures.
4. If, after having conducted a risk assessment and ascertained a lower risk of money laundering or terrorism financing, verification procedures for a counterparty have not been completed prior to the establishment of the business relationship, the SPV may complete the verification before the payment of any proceeds or distributions, including dividends. Payments should be made only to the investor and not to a third party and only when the outstanding due diligence documentation has been verified.

Ongoing Monitoring

5. Ongoing monitoring should take place to ensure that documents, data, or information collected during the various due diligence procedures on counterparties are kept up-to-date and relevant. SPVs should ensure that the counterparties are periodically screened against the vigilance databases/sanctions lists. Periodic reviews should also be conducted on the counterparties and the frequency of periodic review should be based on their risk rating. Due to the nature of the activities of an SPV, ongoing monitoring will likely be focused primarily on relationships rather than transactions and as such, will likely be performed by persons rather than through the use of electronic systems. For further guidance on on-going monitoring, reference should be made to section 4 H of Part II of these Guidance Notes.

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G. PARTICULAR ISSUES ON VERIFICATION OF IDENTITY OF INVESTORS

One-off transactions

1. For the purpose of the Guidance Notes, a subscription to an SPV should not be treated as a one-off transaction (for which see section 4 of Part II of the Guidance Notes).

If the investor is a fund domiciled outside an AMLSG List Country but is administered in an AMLSG List Country

2. In such a case, where the risk rating is low the investor may fall within one of the specified scenarios in which simplified CDD would apply.
3. Evidence may also be satisfactory if the investor's administrator:
 - is subject to the AML/CFT regime of the AMLSG List Country; and
 - confirms in writing that it has obtained and maintains customer verification evidence in accordance with the procedures of the AMLSG List Country.

Depository/Clearing House

4. In some cases, depositories or clearing houses will be another intermediary between the SPV, the placement agent and the beneficial owner of the securities issued by the SPV. In addition, the ownership of securities may be recorded in book-entry or uncertificated form. In that case, nominee investors, most often the placement agents, are the investor of record for the clearing house but in reality they hold the security for the benefit of underlying ultimate beneficial investors. Where the depository, clearing house or nominee investors are acting in the course of a business that is established in an AMLSG List Country and that is supervised for AML/CFT purposes, verification of identity of the depository, clearing house or nominee investors might not be required, provided the AML/CFT risks identified are low. In addition, in certain cases, the SPV may be able to rely on the due diligence carried out by the nominee investor (as per Section 5 F of these Guidance Notes). For the guidance on 'reliance', reference should be made to section 2 C. 8C of Part II.

H. INTERNAL CONTROLS (refer also to sections 9, 10 and 4 of Part II)

1. FSPs must have policies and procedures in place as required by the AMLRs. These shall include policies and procedures to- (1) identify and report suspicious activity; (2) monitor and ensure internal compliance with laws relating to AML/CFT; and (3) test the efficacy and efficiency of their AML/CFT systems and update such systems, if necessary, to comply with their AML/CFT obligations (the "Procedures").
2. Both SPVs and their service providers are subject to the AMLRs and each has separate obligations to maintain and implement such Procedures in respect of

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their relevant financial business. The ultimate responsibility for maintaining and implementing satisfactory Procedures remains with each FSP.

3. An SPV can meet its obligations in relation to the Procedures by either- (1) implementing their Procedures directly; (2) delegating the performance of the Procedures to a person; or (3) relying on a person to perform the Procedures.
4. It should be noted that, as they carry on relevant financial business, all SPVs must designate an AMLCO, MLRO and DMLRO¹. Following this designation, the designated person may delegate the performance of this function to another FSP² or rely on any other FSP to perform this function. Please see Part II Section 2.C 8 for guidance on delegation and reliance. However, regardless of such reliance or delegation, the SPV remains ultimately responsible for its compliance with AML/CFT obligations.
5. Where an FSP chooses to delegate the performance of its obligations to another person, the FSP should adopt the principles set out in Part II, Section 10.C. ("Outsourcing"). Similarly, where an FSP chooses to rely on a person for the performance of its obligations, the FSP should adopt the principles set out in paragraphs 1 through 5 under 8C of Part II, Section 2. C.
6. The directors of the FSP should document, either as a board resolution or otherwise, the manner in which the vehicle has met the obligations described above.

I. **RECORD KEEPING** (refer also to Sections 8 and 11 of Part II)

What specific records should be kept and where?

1. Refer to Sections 54 and 55 of the Companies Law (2018 Revision).
2. There are instances when it may be impractical for the SPV itself to maintain records. However, in such instances, the SPV must ensure that all appropriate records are maintained (as required by the AMLRs) on its behalf.

When may a successor FSP rely on the customer verification evidence obtained by its predecessor?

3. Where a successor firm is appointed to perform an FSP function for an existing SPV, the successor must ensure that the necessary due diligence has been performed prior to performing the function.
4. It may be possible to rely upon the evidence of identity obtained by a predecessor FSP provided that the original files, or certified copies of the original files, are transferred to the FSP and the successor firm has assessed the quality of the evidence on investor identity as being adequate.
5. Where insufficient evidence exists or a long time has passed since the due diligence was last updated, it may be appropriate to supplement it with additional evidence to meet the standards required by these Guidance Notes.

¹ Reg. 3(1) and 33 AMLRs (2018)

² Reg. 3(2) Anti-Money Laundering (Amendment) Regulations, 2018

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6. At no time would it be appropriate to rely upon an eligible introducer letter as a method for the customer verification evidence obtained by its predecessor.

J. MONEY LAUNDERING/TERRORIST FINANCING WARNING SIGNS

1. In addition to the risk factors in Section 3 of Part II and the warning signs set out in Appendix D of the Guidance Notes, risk factors and ML/TF warning signs to which SPVs and parties to securitizations must have regard to in order to satisfactorily assess the ML/FT risks pertaining to a particular business relationship or transaction include:
 - (1) Assets that are the object of the securitization have been the object of legal measures;
 - (2) The present or previous owner of the assets has criminal convictions;
 - (3) Assets involved in the securitization are difficult to quantify or are in locations difficult to access;
 - (4) Assets exhibit legal inconsistencies as refers to their ownership, possession or tenure, or are overvalued or whose characteristics are not in keeping with the sector;
 - (5) When an investor is more concerned about the subscription and distribution terms of the notes than with other information related to the investment;
 - (6) sudden and unexplained subscriptions and transfers;
 - (7) requests to pay distributions to a third (*unrelated*) party; and
 - (8) a client or investor that exhibits unusual concern with compliance with AML/CFT reporting requirements or other AML/CFT policies and procedures.