



GUIDANCE NOTES (AMENDMENTS) ON THE PREVENTION AND DETECTION OF MONEY LAUNDERING, TERRORIST FINANCING AND PROLIFERATION FINANCING IN THE CAYMAN ISLANDS

Issued by the Cayman Islands Monetary Authority
Pursuant to section 34 of the Monetary Authority Act (2020 Revision)

These Guidance Notes amend the Guidance Notes issued on June 5, 2020
(the "GN of June 5, 2020")

May 2021

This document is intended to provide general guidance to Financial Service Providers ("FSPs"). It should therefore, not be relied upon as a source of law. Reference for that purpose should be made to the appropriate statutory provisions. However, FSPs should be aware of the enforcement powers of the Supervisory Authorities under the Anti-Money Laundering Regulations (2020 Revision) ("AMLRs") and amendments thereto as they relate to supervisory or regulatory guidance.

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1. These Guidance Notes may be cited as the **Guidance Notes Amendment (Securitization), May 2021**.
2. These GNs of June 5, 2020 are amended by inserting Part X.

PART X – SECTOR SPECIFIC GUIDANCE: SECURITIZATION

A. OVERVIEW

1. Securitization is a process that involves creating new financial instruments by pooling and combining existing financial assets, typically through an off-balance sheet bankruptcy remote special purpose vehicle (“SPV”), which purchases the assets using proceeds of securities issued to investors, usually in the form of debt. Payments of interest and principal on these securities is backed by the cash flow generated from the asset pool. Securitization transactions include the issuance of collateralized debt obligations, collateralized 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, preference shareholder and unitholder.
2. The Cayman Islands has company, trust, partnership and related laws that allow a high degree of flexibility for establishing SPVs. Because of their structure, securitization SPVs that are not insurance securitization vehicles are generally not required to be registered or licensed by the Authority under any regulatory law. Regardless, such securitization transactions may present ML/TF/PF risks.

B. SCOPE

1. The sector specific guidance contained in this Part is applicable to non-insurance 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, investment managers, arrangers or sellers of assets (“sponsor”).
2. SPVs themselves are considered to be carrying on relevant financial business under the Proceeds of Crime Act (“POCA”) as amended, and as such are required to comply with the Anti-Money Laundering Regulations (“AMLRs”) as amended and the General AML/CFT/CPF Guidance provided in Part II of the Guidance Notes on the Prevention and Detection of Money Laundering, Terrorist Financing and Proliferation Financing in the Cayman Islands, 5 June 2020 (“Guidance Notes”). In addition, various service providers to the SPVs may also be considered as carrying on relevant financial business under the POCA.
3. In this Part of the guidance, a reference to “SPV” captures only non-insurance securitization vehicles, whereas a reference to “FSP” includes the SPV as well as all its relevant service providers (i.e. those that are carrying on relevant financial business under the POCA). For guidance on insurance special purpose vehicles please see Part V of these Guidance Notes.

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/PF 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/CPF regimes can increase the risk of ML/TF/PF.
 - (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/PF. All things equal, institutional investors and large financial institutions including Clearing Systems (see Section E.3 below), 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** – In circumstances where the sponsor originated the assets or purchased the assets before selling them to the SPV, the sponsor may procure the assets to be pooled using laundered funds or otherwise have illegitimately obtained the asset or may have misrepresented the source of the assets.
 - (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, in circumstances where the sponsor sold the assets to the SPV, 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/CPF 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/CPF 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/PF risks outlined in Section C above and the ML/TF/PF 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/CPF laws and measures and/or is not adequately supervised. Background information, including information from rating agencies may be used to record the purpose of the transaction and to assess ML/TF/PF risks.

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

1. In order to forestall financial crime, including ML/TF/PF, it is important that background knowledge is obtained about all the participants in a securitization 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 relationship 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.
3. In securitization transactions, securities can be issued in global form through clearing systems. The Depository Trust Company in the United States, Euroclear and Clearstream Banking société anonyme in Europe, and the Canadian Depository for Securities are regulated financial institutions based in jurisdictions with strong AML/CFT/CPF regimes. Clearing Systems stand between the issuer and the buyer (becoming the buyer to the issuer and the seller to the buyer) and perform CDD on their participants and account holders. Reliance on a clearing system should be done on a risk-based approach and form part of an FSP’s risk documentation.

Table 1 - Who should be treated as the Applicant for Business?

	FSP	Applicant for Business
1.	The SPV	(1) Investors; or (2) Clearing System
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 company, the directors (see the section on Company Formation and Management)

3.	FSP issuing and administering subscriptions/redemptions.	(1) The SPV; and (2) The investors or Clearing System
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 or Clearing System
6.	Placement agent/arranger	(1) Investors
7.	Clearing system	(1) The SPV; (2) Its participants and account holders; and (3) Placement agent/arranger

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 ML/TF/PF, 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 16 of Part II of these Guidance Notes.

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 (see section 4 of Part II of the Guidance Notes).

Depository, Custody and Nominee Arrangements

2. In some cases, depositories, custodians or nominees 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. In certain cases, the SPV may be able to rely on the due diligence carried out by the nominee investor (as per Section 5, subsection E of these Guidance Notes).

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/CPF; and (3) test the efficacy and efficiency of their AML/CFT/CPF systems and update such systems (the "Procedures"), if necessary, to comply with their AML/CFT/CPF obligations.
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 their carrying on 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. However, regardless of such reliance or delegation, the SPV remains ultimately responsible for its compliance with AML/CFT/CPF obligations. Refer to Part II, Section 2, Subsection C para 8-14 of the Guidance Notes for further guidance on reliance/delegation of AML/CFT/CPF functions.
5. Where an SPV chooses to delegate the performance of its obligations to another person, the SPV should adopt the principles set out in Part II, Section 10 C. ("Outsourcing"). Similarly, where an SPV chooses to rely on a person for the performance of its obligations, the SPV should adopt the principles set out in paragraphs 8 through 14 under Part II, Section 2, Subsection C of the Guidance Notes.
6. The directors, trustee or general partner of the SPV should document, either as a board resolution or otherwise, the manner in which the SPV 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 Act (as amended).
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.

¹ Reg. 3(1) and 33 AMLRs (2018)

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

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.
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/PROLIFERATION 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/PF warning signs to which SPVs and parties to securitizations must have regard to in order to satisfactorily assess the ML/FT/PF 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 with respect 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/CPF reporting requirements or other AML/CFT/CPF policies and procedures.