Changes to Anti-Money Laundering Laws and Practices for Cayman Islands Entities

In response to the Financial Action Task Force ("**FATF**") recommendations to combat money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction, there have been significant changes to the anti-money laundering laws and practices of the Cayman Islands. On 6 April 2018, the Cayman Islands Monetary Authority ("**CIMA**") published a Notice further clarifying the recently issued Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands ("**AML Guidance Notes**"). The AML Guidance Notes together with the Anti-Money Laundering Regulations (2018 Revision) ("**AML Regulations**"), Proceeds of Crime Law (2018 Revision) and the Terrorism Law (2018 Revision) form the revised AML regime ("**Revised AML Regime**").

The most significant changes under the Revised AML Regime are as follows:

- the inclusion of unregulated investment entities and structured finance vehicles within the scope of the Revised AML Regime, by bringing them within the definition of "relevant financial business";
- the new requirements for all investment funds to designate a natural person as the Compliance Officer ("**AMLCO**"), Money-Laundering Reporting Officer ("**MLRO**") and Deputy Money-Laundering Reporting Officer ("**DMLRO**") and to notify CIMA of the identity of such persons: on or before 30 September 2018 for existing funds; and on submission of the registration application for funds registering with CIMA on or after 1 June 2018;
- the introduction of a more comprehensive risk-based approach to anti-money laundering ("**AML**") processes and procedures.

CIMA intends in due course to issue both a set of FAQs and an updated version of the AML Guidance Notes for private sector consultation. These may result in some "fine tuning" of the Revised AML Regime in response to industry feedback.

It should be noted that regulations issued under the Monetary Authority Law introduce a system of administrative fines which may be levied by CIMA for non-compliance with the Revised AML Regime. In addition, the list of Schedule 3 countries which were regarded as having an equivalent regime to the Cayman Islands has been replaced by a new list of approved countries ("**Approved Countries**") determined by the Anti-Money Laundering Steering Group.

What entities are newly subject to the Revised AML Regime?

Investment funds registered with CIMA (being open-ended funds such as hedge funds) were previously and remain subject to the AML regime. Under the Revised AML Regime, unregulated investment entities such as closed-ended funds (including most private equity, venture capital and real estate funds due to the illiquidity of their underlying assets) and structured finance vehicles are now also required to undertake AML due diligence on all existing investors (the ultimate beneficial owners or investors) by 31 May 2018 and to put in place appropriate AML processes and procedures. Whilst at first sight this may appear onerous, in practice much of the information on investors that is needed may have already been requested or obtained as part of the automatic exchange of information ("**AEOI**") required by the Foreign Account Tax Compliance Act ("**FATCA**") and the Common Reporting Standard ("**CRS**").

Entities newly subject to the Revised AML Regime should consider the appropriate measures required to comply with the regime. Whilst it is open for Cayman Islands entities to undertake the various elements required by the Revised AML Regime themselves, most entities will in practice delegate this to a suitable service provider as discussed below. Particular care needs to be taken to comply with CIMA's guidance on outsourcing in relation to the delegation of any function, including the delegation of AMLCO, MLRO and DMLRO positions to natural persons.

In addition, Cayman Islands "Designated Non-Financial Business and Professions" (which include real estate agents and brokers, dealers in precious metals, dealers in precious stones, firms of accountants and firms of attorneys at law) are now also subject to the AML Regulations and the AML Guidance Notes.

Summary of CIMA Notice and changes under AML Guidance Notes

Delegation of AMLCO/MLRO/DMLRO

- A natural person, at managerial level must be appointed as AMLCO, MLRO and DMLRO. This could be a fund administrator staff member, fund director or any other person;
- The delegate may serve as both AMLCO and MLRO if the person is competent, has sufficient time to perform both roles efficiently, and understands the roles and responsibilities of each function;
- In the case of CIMA registered entities, the identity of the delegate must be notified to CIMA in accordance with the deadlines detailed above;
- The delegate must have adequate and appropriate knowledge and expertise to perform the function;
- The Cayman Islands entity must conduct a risk assessment of the delegate before entering into an agreement with the delegate. In particular, the country risk for the country where the delegate is based needs to be analysed and documented;
- The Cayman Islands entity and the delegate need to have a formal agreement, setting out the responsibilities of each party. This does not have to be a separate agreement so can form part of the administration agreement, if staff members of the fund administrator serve in such role;
- The Cayman Islands entity must review the policies and procedures of the delegate prior to engaging the delegate and regularly test those policies and procedures;
- Where the Cayman Islands entity delegates responsibility for, or places reliance on others for, any function

including maintenance of internal policies and procedures, CIMA's outsourcing requirements will apply.

The AMLCO:

- needs to have oversight and conduct ongoing monitoring of a fund's activities, both as regards investor related AML issues and the fund's investment activities;
- needs to have clear reporting lines and receive periodic reports from service providers (e.g. administrators and the investment manager); and
- is expected to have open access to the fund's board of directors or equivalent.

Offering documents can be updated subsequently when convenient to include the appointment of AMLCO, MLRO and DMLRO and their biographies.

Reliance on eligible introducers

Reliance on an eligible introducer is only permissible in a low risk scenario. Accordingly, a risk based approach is required, which will involve documenting and demonstrating that the eligible introducer and the customer introduced are assessed as "low risk".

Delegation of AML procedures

A fund may rely on the AML procedures of an administrator that is subject to the AML regime of an Approved Country if, having considered the suitability of the administrator, it is satisfied that at minimum standards equivalent to the AML regime of the Cayman Islands will be applied by the administrator. This analysis does not have to be a granular comparison but should be sufficient to identify whether minimum standards equivalent to the Cayman Islands AML regime will be applied e.g. that suspicious activity should be identified and reported, including to the Cayman Islands Financial Reporting Authority. If this is not the case, the fund and its administrator must apply the Revised AML Regime. Accordingly, funds must document and demonstrate in writing their assessment of administrators in Approved Countries which includes considering whether the country where the delegate is situated:

- is identified by credible sources, such as mutual evaluation or detailed assessment reports, as having effective AML/ counter finance of terrorism ("**CFT**") systems which may be regarded as generally equivalent to those applied in the Cayman Islands ;
- is identified by credible sources as having a low level of corruption or other criminal activity; and
- has local regional variations in AML/CFT risk between different regions or areas within a country.

Fund administrators based in certain Approved Countries, for example the United States and Hong Kong, are not generally regarded as subject to an AML regime that is equivalent to the Cayman Islands. In those countries, delegation will only be sufficient to constitute compliance if the administrator adheres to and provides services in accordance with the Revised AML Regime. In such cases, the Cayman Islands fund should undertake a "gap analysis" to identify the difference between compliance requirements of the Cayman Islands and the relevant

jurisdiction. If a "gap" is identified, it must be addressed, for instance by the administrator agreeing to apply the Revised AML Regime or the fund appointing another delegate who can ensure compliance with the requirements of the Revised AML Regime.

Identification of investors

The former AML regime permitted a full exemption from identification of investors into Cayman Islands funds where subscription monies were paid from a bank account in a Schedule 3 country, on the basis that the bank would have undertaken AML identification of investors. CIMA has confirmed that under the Revised AML Regime, provided that: (i) the subscription funds are remitted from an account held in the customer's name at a bank in the Cayman Islands or a bank regulated in an Approved Country; and (ii) the investor has been assessed as low risk, the fund may defer to verify customer identity at the time of subscription. However, full AML identification of each customer is generally required prior to payment of redemption proceeds to the customer (even when funds are remitted back to the bank account from which the subscription was made).

Notwithstanding the above, CIMA have indicated that, for the time being, where the administrator knows the investor's identity and the investor has been assessed as low risk, then redemption proceeds may be remitted back to the bank account from which the subscription was made without conducting full AML identification. This reflects the risk based approach allowing a reduced level of AML identification when dealing with "known" counterparties in low risk scenarios. This may be clarified further in the future FAQs and updated AML Guidance Notes to be issued by CIMA. It should be noted that the identification information required may to a substantial degree already have been obtained as part of the AEOI requirements for FATCA and CRS.

Other changes

Other significant changes include the introduction of the following additional requirements:

- conducting employee screening procedures when hiring employees;
- conducting checks against all applicable sanctions lists and lists of countries which are regarded as non-compliant with the FATF recommendations;
- conducting enhanced due diligence on politically exposed persons; and
- adopting a risk-based approach in AML/CFT procedures appropriate for the fund's organisation, structure and business activities.

In relation to the risk-based approach for AML/CFT procedures, where a fund has not delegated this function to an administrator, it will involve identifying AML/CFT risks to the fund and assessing such risks in relation to the fund's investors and the countries/geographic areas in which the investors reside. This requires funds to classify all investors as high, medium or low risk. A fund will also need to carry out and document a risk assessment of its activities and investments. The methodology for such assessment should be documented in a compliance manual.

Simplified and enhanced due diligence considerations

While the risk-based approach allows for simplified due diligence in certain circumstances, it also requires enhanced due diligence where appropriate. This permits financial service providers to implement procedures which are appropriate to the type and size of their business and nature of the clients.

Simplified due diligence can be applied in low risk scenarios for:

- Cayman Islands entities that are financial service providers and subject to the Revised AML Regime;
- government organisations, statutory bodies or government agencies of foreign countries and territories in Approved Countries;
- entities which are regulated in an Approved Country;
- companies listed on a recognised stock exchange; and
- customers introduced through an intermediary financial/professional firm (Eligible Introducer), where such financial/professional firm certifies that it has undertaken AML identification of that person.

Where simplified due diligence may be applied, identification/verification documents do not need to be obtained.

Where "enhanced due diligence" is required, more detailed and more regular AML identification of the beneficial owner(s) of a corporate investor is required. The definition of beneficial owner is based on the FATF recommendations.

What penalties are in place for non-compliance with the Revised AML Regime?

Any person subject to the Revised AML Regime who breaches the regime commits a criminal offence and, on summary conviction, is liable to a fine of up to CI$500,000 (increased from CI$5,000 under the previous regulations) or on conviction on indictment is liable to an unlimited fine and imprisonment for two years.

In addition, CIMA now has authority to impose fines for breaches of the Revised AML Regime. Breaches range from "minor" to "serious" or "very serious" and may result in fines from US$6,000 for minor breaches to US$120,000 for individuals and US$1.2 million for entities for very serious breaches.

Penal Code amendments

Separately, amendments to the Penal Code make it an offence under Cayman Islands law to deliver false or fraudulent information, or to omit to provide information, to the Cayman Islands Government in connection with the collection of money for the purposes of general revenue. Whilst this will have limited application given the lack of direct taxation in the Cayman Islands, it reinforces that foreign tax offences are regarded as crimes under Cayman Islands law under the principle of dual criminality, and hence are reportable under the AML regime.

What steps should now be taken?

We recommend that existing arrangements, including any delegation arrangements, should now be reviewed to ensure that they comply with the Revised AML Regime. Such arrangements should then be reviewed on a regular basis. Funds and other financial service providers should document how they intend to comply with the Revised AML Regime in board resolutions and any administration agreement should set out the AML responsibilities of the administrator. In addition, any form of delegation (including of AML responsibilities) needs to comply with the guidance on outsourcing issued by CIMA. Funds already registered with CIMA should contact us in good time to assist with notifying CIMA of the identity of the persons to serve as their AMLCO, MRLO and DMLRO by 30 September 2018.

It is expected that the AML Guidance Notes will be amended further to include sector specific guidance for those newly within the Revised AML Regime, including unregulated investment entities.

Further information

This briefing paper has been prepared on the basis of the law and practice as at 16 April 2018 for the assistance of client Cayman Islands entities in determining their obligations to comply with anti-money laundering laws. It is not intended to be comprehensive in its scope and it is recommended that clients seek specific legal advice. Campbells can advise and assist on these matters. For further information on the matters referred to in this briefing paper, please contact one of the below or your usual contact.

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