

Cayman Islands and the EU AML High-Risk Third Countries List

On 7 January 2022, the European Commission adopted a draft Delegated Regulation (the "Draft Regulation"¹) updating its list of 'high-risk third countries' ("EU AML List") identified as having strategic deficiencies in their anti-money laundering/counter-terrorist financing ("AML/CFT") regimes².

The Draft Regulation proposes to add nine countries, (including the Cayman Islands) and to remove five countries from the EU AML List³. It will be submitted to the Council of the EU and the Parliament for approval. If neither objects, it will be published in the Official Journal of the EU and will enter into force 20 days after publication.

This update briefly analyses the practical consequences of the Cayman Islands' potential addition to the EU AML List for clients using Cayman Islands vehicles.

Why the proposed addition?

The European Commission is committed to greater alignment with the Financial Action Task Force ("FATF") listing process and the proposed addition of the Cayman Islands to the EU AML

List is a direct result of the inclusion of the Cayman Islands on the FATF's list of jurisdictions under increased monitoring in the area of AML/ CFT/CPF ("FATF Monitoring List") in February 2021, as discussed in our previous client update⁴. However, it should be noted that the FATF and EU listing regimes are not currently aligned. The FATF operates dual lists whereas the EU maintains a single list. The FATF Monitoring List (sometimes referred to as the FATF's 'grey' list) comprises jurisdictions that are actively working with the FATF to address strategic deficiencies in their AML/CFT regimes. This is distinct from the FATF 'Call for Action' / 'Non-Cooperative Jurisdiction' list (sometimes referred to as the FATF 'black' list). The section below entitled "*Planned Changes to EU AML Laws*" considers proposals for EU reform to move to this dual list model.

It is noted in the Draft Regulation's recitals that work by the Cayman Islands is continuing to address its strategic deficiencies identified by the FATF relating to (i) having effective sanctions where parties fail to file requisite information on beneficial ownership; and (ii) demonstrating that it is effectively prosecuting

¹<https://webgate.ec.europa.eu/regdel/web/delegatedActs/1688/documents/latest?lang=en>

² Article 9 of the Fourth Money Laundering Directive (EU) 2015/849 ("MLD4") empowers the European Commission to adopt delegated acts to identify high-risk third-countries.

³ Countries proposed to be added: Burkina Faso, Cayman Islands, Haiti, Jordan, Mali, Morocco, the Philippines, Senegal,

and South Sudan. Countries proposed to be removed: The Bahamas, Botswana, Ghana, Iraq and Mauritius.

⁴ <https://maples.com/en/knowledge-centre/2021/2/cayman-islands-and-the-fatf-monitoring-list>

money laundering cases in line with the jurisdiction's risk profile.

In October 2021, the FATF positively recognised the efforts of the Cayman Islands to improve the AML/CFT regime with respect to these deficiencies, as discussed further below.

Practical Consequences

AML/CFT and Enhanced Customer Due Diligence

Any entity subject to EU AML/CFT laws is required to apply enhanced due diligence and ongoing monitoring processes for any of its customers / clients established or resident in an EU AML List jurisdiction. The measures to be applied will vary, but may result in:

- (a) a requirement to perform more comprehensive due diligence on the customer / client's source of funds and source of wealth (e.g. further information may need to be provided to financial intermediaries such as correspondent banks); and / or
- (b) increased internal controls on business acceptance and ongoing monitoring.

Securitisations

Amendments made to the EU Securitisation Regulation (EU) 2017/2402 on 9 April 2021 affect the use of special purpose vehicles ("SPVs") established in non-EU jurisdictions included on the EU AML List. Accordingly, specific advice should be taken by affected EU entities in relation to securitisations (defined in the EU Securitisation Regulation) which use Cayman Islands SPVs.

Investment Funds and EU Marketing

Inclusion on the EU AML List shall not prevent Cayman Islands investment funds from being

marketed into the EU under national private placement rules under the Alternative Investment Fund Managers Directive (EU) 2011/61 ("AIFMD"). However, in November 2021 the European Commission published proposals to amend AIFMD. If the Cayman Islands is added to the EU AML List and remains on it at the point that the proposed AIFMD changes come into effect, this could theoretically restrict Cayman Islands domiciled investment funds from marketing in the EU under the national private placement regimes. However, the AIFMD proposals are not expected to take effect until 2024 and may be impacted by planned EU AML law changes in the interim, as discussed below.

EU Public Funding

EU-related development agencies may not be able to lend development funding to the Cayman Islands or to entities established in the Cayman Islands, subject to certain exceptions. However, we understand that this facility is not broadly used in practice and, therefore, we would not expect this to have a material impact.

Tax Implications

Inclusion on the EU AML List should not impact any existing representations or commitments made by tax authorities under agreements with the Cayman Islands in the area of international mutual tax cooperation. Equally, the listing is not a tax measure so would not, for example, have any impact on dealings with Cayman Islands counterparties under the EU's DAC6 tax reporting regime.

Planned Changes to EU AML Laws

As part of a wider reform package of EU AML/CFT law, the European Commission has recently published a new draft AML/CFT Regulation. Please refer to our client update on

this for more details⁵. These reforms aim to move away from the current approach (in MLD4) of prescribing a single list of AML high-risk third countries. It is proposed that the EU regime will be aligned with the FATF dual list approach and distinguish between:

- (i) Third countries where significant strategic deficiencies in the legal and institutional AML/CFT framework of the third country have been identified; and
- (ii) Third countries with compliance weaknesses.

The new EU AML/CFT regulatory framework (including the draft AML/CFT Regulation) is expected to be fully operational by 2024 and may have implications for other EU legislative reforms, including the AIFMD proposals noted above.

FATF Plenary and Cayman Islands Government Response

At their October 2021 plenary, the FATF positively recognised the ongoing efforts of the Cayman Islands to improve its AML/CFT regime.

The FATF acknowledged that the Cayman Islands has applied and shall sustain *"sanctions that are effective, proportionate and dissuasive, including administrative penalties and other enforcement actions against obliged entities to ensure that AML/CFT breaches are remediated."*

It is therefore understood that the FATF considers that the Cayman Islands is making positive progress on satisfying the final outstanding recommendations arising from the effectiveness assessment and that the jurisdiction has already satisfied the vast

majority of the heads of assessment. The Cayman Islands is also either 'compliant' or 'largely compliant' with all 40 FATF technical recommendations. Assuming this positive progress continues, it is reasonable to expect that the Cayman Islands will be removed from the FATF's Monitoring List in the relative short term.

On 12 January 2022, the Ministry of Financial Services & Commerce of the Cayman Islands Government issued an Industry Advisory acknowledging the release of the Draft Regulation. It notes that the Ministry is continuing to hold direct discussions with EU officials with a view to making progress on regime enhancements to facilitate the jurisdiction's removal from the list.

Further Information

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⁵ <https://maples.com/en/knowledge-centre/2021/9/european-commission-publishes-new-aml-cft-action-plan>

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