

ADVISORY | FINANCE & CORPORATE AND FUNDS

The Cayman Islands comes off AML risk lists, signaling robust controls

Associating the Cayman Islands with money laundering has been a staple of film and television, from "The Firm" in the 1990s to, more recently, "Better Call Saul."

However, scriptwriters may need to find another location to reference, as the Financial Action Task Force in October 2023 assessed the Cayman Islands as having more robust controls to prevent money laundering, terrorist financing, proliferation financing and breaches of financial sanctions than most other countries.

Background

In its Mutual Evaluation Report of 2019, the FATF recognized that the Cayman Islands is host to an innovative and advanced financial sector that plays an important role in the international marketplace.

The stated desire of the FATF since 2019 was that the role this significant international financial center plays in the global economy necessitates that there is a suitable framework in place to mitigate the use of the Cayman Islands as a potential means to launder funds.

Steps Taken to Strengthen AML Regime

Since then, the Cayman Islands, a British overseas territory, has taken steps to further strengthen its anti-money laundering and countering financing of terrorism and proliferation, or AML/CFT, regime.

The AML/CFT regime applicable in the Cayman Islands meets international standards in this area, as evidenced by the removal of the Cayman Islands from:

- The Financial Action Task Force's list of jurisdictions under increased monitoring, known as the FATF gray list on Oct. 27, 2023; and
- The U.K. list of high-risk countries for AML and counterterrorist financing purposes, or the U.K. AML risk list, on Dec. 5, 2023, pursuant to the Money Laundering and Terrorist Financing (High-Risk Countries) (Amendment) (No. 2) Regulations 2023.

In addition, as of Feb. 7, the Cayman Islands will also be removed from the EU list of third-country jurisdictions that have strategic deficiencies in their AML/CFT regimes or the EU AML list.

This follows the adoption of the Commission Delegated Regulation by the European Commission on Dec. 12, 2023,^[2] regarding the deletion of the Cayman Islands and Jordan from the annex.

The Cayman Islands was added to the FATF gray list and, consequently, the EU and U.K. AML risk lists, not due to any issues with its legislative or supervisory frameworks for AML/CFT, but rather around the need for it to demonstrate effective regulatory and administrative sanctions and prosecutions.



In a statement by the FATF accompanying the announcement that the Cayman Islands is no longer on the FATF gray list, the FATF said that it "welcomes the Cayman Islands' significant progress in improving its AML/CFT regime," and noted that "the Cayman Islands strengthened the effectiveness of its AML/CFT regime to meet the commitments in its action plan regarding the strategic deficiencies that the FATF identified in February 2021."

The EU regulation similarly notes that the Cayman Islands has strengthened the effectiveness of its AML/CFT regime and that it has addressed technical deficiencies to meet the commitments in its action plan on the strategic deficiencies identified by the FATF.

Accordingly, the commission has concluded that the Cayman Islands no longer has strategic deficiencies in its AML/CFT regime.

The removal of the Cayman Islands from the FATF gray list, the EU and U.K. AML risk lists are significant milestones in, and evidence of, the Cayman Islands' commitment to AML/CFT. However, it is important to understand that the Cayman Islands has achieved more than simply its removal from the aforementioned lists.

Instead, the Cayman Islands' commitment to the development of a robust AML/CFT regime is more particularly evidenced by the fact that the Cayman Islands is rated by the FATF as being largely or wholly compliant with all 40 of the FATF recommendations, a level of compliance that almost none of the EU member states and G20 members currently meet.

The FATF recommendations are the global comprehensive and consistent framework of measures that countries should implement to combat money laundering and terrorist financing, as well as the financing of the proliferation of weapons of mass destruction.

The FATF mutual evaluation of FATF members is an ongoing process, meaning that member countries are subject to intensive assessment of their implementation of the FATF's standards, with the fifth round to commence in 2025.

The size and scale of the financial services sector means that the Cayman Islands of the mid-2020s is increasingly a jurisdiction that is a positive force against money laundering, terrorist financing and proliferation financing.

In numerical terms, the Cayman Islands remains home to approximately 100 banks and trust companies and around 700 insurance companies, as well as over 30,000 regulated open and closed-ended investment funds, with assets under management of around \$8.5 trillion.

The number of investment funds established in the Cayman Islands continues to grow year-on-year. The jurisdiction vies with the U.S. to be the world's largest fund domicile, with the Cayman Islands and the U.S. each having around a third of the world's alternative investment funds, and the next largest jurisdiction, Luxembourg, a fraction of that.

Thus, the Cayman Islands' scale as an international financial center means it has to work harder than many other countries to ensure it is not used for financial crime. Recognition by the FATF, the EU and the U.K. of the jurisdiction's achievements is significant.



Concluding Thoughts

On a practical level, while the FATF gray list, the EU and U.K. AML risk lists did not give rise to any bans or penalties for the Cayman Islands, its removal from the EU and U.K. AML risk lists means that enhanced customer due diligence measures will no longer apply to business relationships and transactions involving the Cayman Islands by virtue of being on these lists. Due diligence was expressly not required as a result of being on the FATF gray list.

This will be a benefit to those conducting financial services with Cayman Islands entities, as it will simplify the due diligence to be conducted in relation to such entities. For example, a bank in London or the EU need not subject a potential Cayman Islands counterparty to enhanced due diligence.

The removal of the Cayman Islands from the EU AML list also means that EU financial institutions will no longer be prohibited, pursuant to Article 4 of the EU Securitization Regulation, from establishing new securitization special purpose entities in the Cayman Islands.

The Cayman Islands is a world-leading jurisdiction for securitization special purpose entities and although the vast majority of these were unaffected by the jurisdiction's appearance on the EU AML list as they had no EU nexus, those that were affected are now already returning.

The Cayman Islands has also been at the forefront of adopting other international regulatory regimes over the past few years. It participates in numerous international regimes intended to prevent harmful tax practices and promote the sharing of tax-relevant information, including the U.S.-focused Foreign Account Tax Compliance Act, as well as the over 100 jurisdictions committed to exchanging information with each other under the Organization for Economic Cooperation and Development's common reporting standard.

The Cayman Islands was one of the earliest adopters of both regimes, automatically sharing the information collected with participating tax authorities worldwide and is committed to maintaining international standards in relation to its AML/CFT regime. It is expected that the Cayman Islands will continue to amend and expand its AML/CFT regime, as necessary, to comply with such standards.

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