GUIDANCE NOTE

UNREGULATED FUNDS AND THE NEW AML REGIME IN THE CAYMAN ISLANDS

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WHAT ARE THE CHANGES?

The Anti-Money Laundering Regulations, 2017 (the "**Regulations**") were brought into force on 2 October 2017 and replaced the Money Laundering Regulations (2015 Revision) (the "**Former Regulations**").

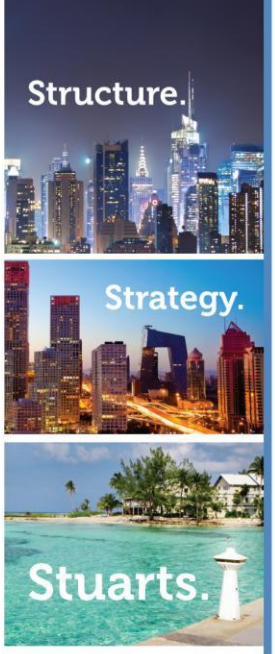
The principal aim of the Regulations is, as the name suggests, to combat money laundering and the financing of terrorism. Rather than bringing about wholesale changes, the Regulations are really a further iteration of the regime set out in the Former Regulations and the accompanying Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands (the "**Guidance Notes**"). The Regulations codify some of the recommendations previously set out in the Guidance Notes and also seek to more accurately reflect the 2012 recommendations of the Financial Action Task Force.

The principal changes brought about by the Regulations are as follows:-

1. **Extended Application** – The Former Regulations applied to those who conducted 'relevant financial business', as such term was defined therein. However, the Regulations now refer to the definition of 'relevant financial business' set out in the Proceeds of Crime law (2017 Revision) (the "**POC Law**"). This definition, importantly, has extended the list of activities which constitute 'relevant financial business' to specifically include "investing, administering or managing funds or money on behalf of other persons". Accordingly, regulated and unregulated investment entities and finance vehicles (including private equity and closed-ended funds) are within the scope of the Regulations and will be required to comply with them.

2. **A risk-based approach** – A person or entity that conducts 'relevant financial business' (an "**Affected Entity**") is required, as a result of the Regulations, to take steps appropriate to the nature and size of the business to identify, assess and understand its money laundering and terrorist financing risks in relation to: (1) a customer of the Affected Entity, (2) the country or geographic area in which the customer resides or operates, (3) the products, services and transactions of the Affected Entity and (4) the delivery channels of the Affected Entity.

3. **Additional mandatory procedures** – The Former Regulations list a number of procedures which an Affected Entity is required to maintain. These include KYC/client identification procedures, record-keeping procedures, appointing someone in a managerial position to be the Compliance Officer and a Money Laundering Reporting Officer and training its employees on the anti-money laundering regime. The Regulations preserve these mandatory procedures but also now require an Affected Entity to undertake screening of their employees



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and to undertake sanction and Financial Action Task Force non-compliant territory checks.

4. **Simplified Due Diligence** – If an Affected Entity assesses a customer to be lower risk (acting consistently with the findings of the Anti-Money Laundering Steering Group, established under the POC Law (the "**Steering Group**")), the Regulations enable the Affected Entity to apply simplified due diligence procedures.

5. **Enhanced Due Diligence** – If an Affected Entity assesses a customer to be higher risk (acting consistently with the findings of the Steering Group), enhanced due diligence will be required. We await the updated Guidance Notes which will provide guidance as to the specific nature of these enhanced procedures.

6. **List of Jurisdictions with Equivalent Regimes** – The list of jurisdictions with equivalent anti-money laundering procedures listed in Schedule 3 of the Former Regulations (commonly referred to as 'Schedule 3 jurisdictions') has been replaced with a list to be maintained by the Steering Group.

HOW DOES THIS AFFECT A CLOSED-ENDED/UNREGULATED FUND?

Fundamentally, due to the revised definition of 'relevant financial business', a closed-ended/unregulated fund will now be required to comply with the POC Law, the Regulations and the Guidance Notes.

This requires the establishment and maintenance of various procedures for due diligence of the relevant entity's investors, the training of its employees, the appointment of certain officers and the reporting of any issues.

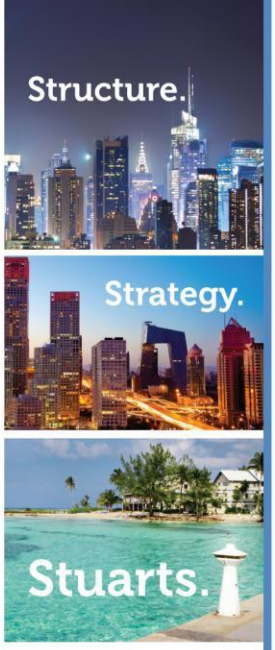
The Regulations are in force as of 2 October 2017 but, in order to provide sufficient time for those entities that are now finding themselves subject to this regime to be compliant, there will be no enforcement against them until 31 May 2018.

The revised Guidance Notes, when issued, are expected to contain a specific section detailing how a closed-ended/unregulated fund should ensure compliance.

WHAT SHOULD INVESTMENT FUNDS BE DOING NOW?

A closed-ended/unregulated fund should consider whether its operations fall within the definition of 'relevant financial business' and, if so, it should consider taking the following steps:-

1. **Review its existing client identification/KYC procedures** – The fund will presumably already be conducting client identification/KYC procedures (whether by itself or through a delegate) in order to comply with obligations under FATCA/the Common Reporting Standard (the "**AEOI Regime**"). The Cayman Islands anti-money laundering client identification/KYC procedures



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now more closely match the requirements of the AEOI Regime. Accordingly, the Affected Entity may already be complying with the client identification/KYC procedures required under the Regulations by virtue of compliance with the AEOI Regime. The fund should review this procedure (or check with the delegate who conducts these procedures on behalf of the fund) to ensure compliance with the Regulations and, where the fund engages delegates, consider expanding the scope of such delegation to include compliance with the Regulations.

2. **Appoint the required officers** – The Regulations would require a fund to appoint an Anti-Money Laundering Compliance Officer, Money Laundering Reporting Officer and a Deputy Money Laundering Reporting Officer. These officers can also be provided by a delegate.

3. **Engage a service provider to ensure compliance with the Regulations** – The Regulations enable compliance to be delegated by a fund to a service provider. Typically, an open-ended/regulated fund would delegate this to the administrator of the fund. However, a closed-ended/unregulated fund without an administrator may need to delegate compliance to the manager/sponsor of the fund. The manager/sponsor of the fund may not, however, be resourced/prepared to provide such services and so the fund can consider engaging a third party in this regard. We can facilitate introductions to third party providers if this would be of assistance.

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This publication is for general guidance and is not intended to be a substitute for specific legal advice. Specialist advice should be sought about specific circumstances. If you would like further information please contact:

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