

EUROPEAN COMMISSION TO BAN CAYMAN SECURITISATION SPVs

In June 2021, following action by the Financial Action Task Force (FATF) we [published a briefing](#) outlining concerns that AML-related actions of the EU might make it more difficult for European entities to deal with Cayman securitisation SPVs. In [a document dated 7 January](#), the European Commission has proposed to add the Cayman Islands to its list of jurisdictions which have strategic deficiencies in their Anti-Money-Laundering / Counter Terrorist Financing (AML/CFT) regimes that pose significant threats to the financial system of the EU. In this briefing we set out the next steps and possible consequences for EU entities who have relationships with Cayman securitisation SPVs. We also consider the implications for non-EU sponsors of Cayman securitisation SPVs that seek EU investors.

BACKGROUND

By way of background, the EU has general legislative controls in relation to AML/CTF concerns in connection with, among other matters, cross-border investments. The principal legislation is [Directive \(EU\) 2015/849](#) (as amended), commonly known as the Anti-Money-Laundering Directive or "**AMLD**". One feature of AMLD is an obligation on the Commission to maintain a list of jurisdictions which have strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the EU (the "**AML blacklist**"). There are a variety of consequences that follow in relation to designation on this list. The number of those consequences appears to be growing, with a general trend beginning to appear for EU financial services legislation to refer to the AML blacklist rather than its FATF equivalent. One important consequence arises under Article 4 of the EU Securitisation Regulation (the "**EUSR**"), which states that securitisation special purpose entities (or "**SSPEs**") "shall not be established" in a country on the AML blacklist. The general way in which the prohibition is formulated creates some doubt about the specific consequences of a country being listed, but we believe the correct view is that it creates a general obligation on any entity regulated under the EUSR to avoid dealings with SSPEs established in those countries.

Key issues

- The Cayman Islands are likely to be added to the EU's AML blacklist from late February or early March 2022.
- Being blacklisted will have a range of consequences, including Cayman SSPEs being banned under the EU Securitisation Regulation.
- Entities regulated under the EUSR will need to consider their existing and future relationships with Cayman SSPEs.
- Once the Cayman Islands are added to the AML blacklist, EU investors will not be able to invest in Cayman SSPEs, and may need to consider divesting from existing investments.
- This represents a divergence from the UK regime. The relevant provision of the UK Securitisation Regulation references the FATF list of high risk jurisdictions, which does not include the Cayman Islands.

RECENT DEVELOPMENTS AND NEXT STEPS

In our June 2021 briefing, we noted there was an increased likelihood of the Cayman Islands being added to the EU's AML blacklist. This was because FATF had recently added the Cayman Islands to its own list of "jurisdictions under increased monitoring" – the less serious of FATF's two categorisations (the other being "high-risk jurisdictions subject to a call for action", a category that includes only Iran and North Korea). The Cayman Islands stayed on FATF's monitoring list when it was updated in October 2021 and the European Commission has now formally proposed to add the Cayman Islands to its AML blacklist in a document dated 7 January.

Under AMLD, the changes proposed by the Commission will be final if no objection has been expressed by either the European Parliament or the Council within a period of one month of them being notified – or sooner if they both inform the Commission that they will not object. The Commission normally consults the legislative bodies before making proposals of this nature, so it seems unlikely that any objection will be forthcoming. The changes then need to be published in the Official Journal and come into force twenty days later, which is likely to be late February or early March.

If the Cayman Islands is added as proposed, then SSPEs established in that jurisdiction would be prohibited under the EUSR. Practically speaking, this means that EU entities acting as originators and sponsors may not establish an SSPE in the Cayman Islands and may need to consider whether existing SSPEs can continue to be organised in the Cayman Islands.

From an investor perspective, we consider this means that EU investors would also be prohibited from investing in any instruments issued by an SSPE established in the Cayman Islands from the date its listing becomes effective. It is unclear whether divestment would be required where an investor already held a securitisation position in a Cayman SSPE. But even assuming they didn't have to divest, liquidity would still immediately be affected as EU investors would cease to be buyers in the market for any Cayman-issued securities. This is particularly relevant for certain CLO transactions backed by US loans and managed by US collateral managers issued by Cayman Islands SSPEs that seek EU investors by complying with the applicable requirements of the EUSR.

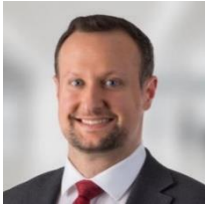
Needless to say, there are more general consequences of the Cayman Islands being listed on the EU's AML blacklist – including enhanced customer due diligence requirements – that market participants also need to consider.

CONCLUSION

Given the likelihood of the Cayman Islands being added to the AML blacklist next month, market participants should immediately start considering whether they can continue with any transactions they are currently working on using Cayman SSPEs.

In addition, EU parties who have an existing involvement with Cayman SSPEs should begin the process of reviewing those relationships and exploring what, if any, changes are necessary to manage the increased regulatory risks. Deciding on and implementing an appropriate course of action – which may require taking specialist advice – may take time, so parties would be well advised to begin that process as soon as practicable.

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