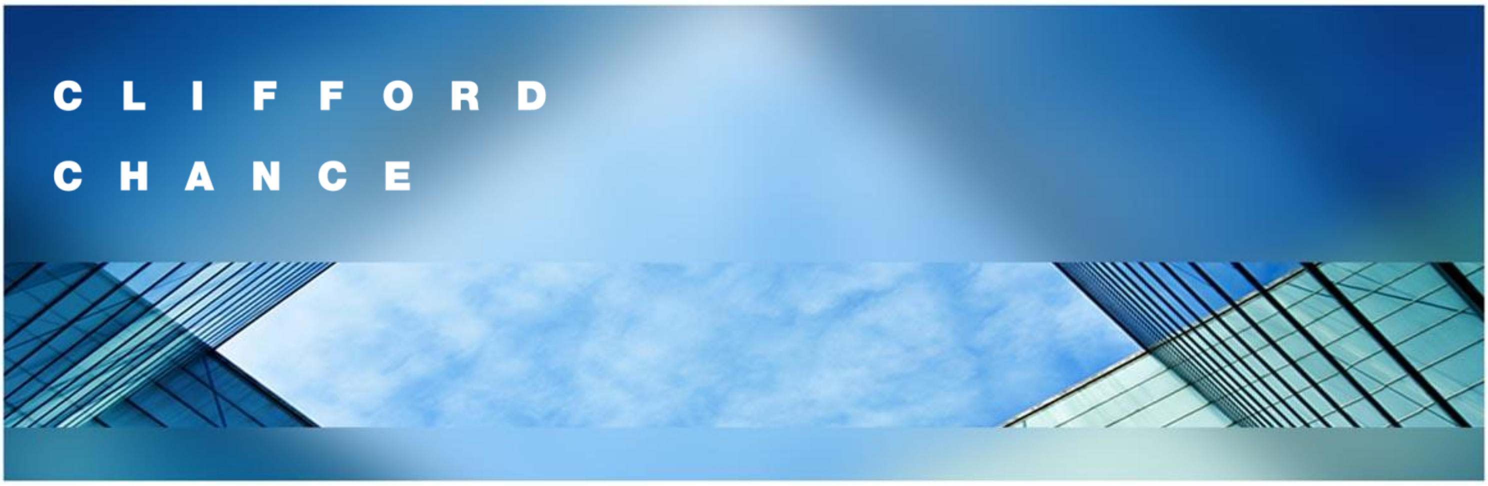

EUROPEAN INVESTORS AND CAYMAN SECURITISATION SPVs – A DICEY PROPOSITION?

There have been concerns in the European securitisation markets recently with respect to the Cayman Islands, largely prompted by their inclusion on the Financial Action Task Force's (the FATF) Monitoring List (the "**FATF greylist**"). Recent changes to the EU Securitisation Regulation also play a role. In this briefing, we explore these concerns and assess possible consequences for both EU and UK investors.

Key issues

- The Cayman Islands have been added to a monitoring list by the Financial Action Taskforce, leading to concerns that it may become more difficult to invest in Cayman-issued transactions.
- Should the Cayman Islands be added to any of the FATF blacklist, the EU tax blacklist, or the EU AML blacklist, then European investors would have difficulty investing, and liquidity would be immediately affected.
- Should the Cayman Islands be added to the EU tax greylist, investment would continue to be allowed, but EU investors would need to notify their home tax authorities of any investments, which may be a disincentive to investing.

GENERAL OVERVIEW

Both the EU and the UK have controls around cross-border investments based around anti-money laundering/counter-terrorist financing (AML/CTF) concerns on the one hand, and tax cooperation on the other. In the securitisation markets these concerns are translated into prohibitions contained in Article 4 of the EU and UK Securitisation Regulations, respectively. In each case, these provisions specify categories of countries in which it is not permitted to establish securitisation special purpose entities ("**SSPEs**"). Recent changes to the EU Securitisation Regulation have expanded these categories and created a further category of countries where investing requires notification to the investor's home tax authorities. The UK rules remain largely in the form of the EU's old (less restrictive) rules.

The addition of the Cayman Islands to the FATF greylist, a monitoring list for countries whose AML/CTF efforts have deficiencies, does not in itself affect whether a European investor can invest in a Cayman-issued securitisation; SSPEs continue to be permitted to be established there under both EU and UK rules. However, listing of the Cayman Islands has generated concern (or stoked existing concerns) that further steps might be taken soon.

WHAT FURTHER STEPS MIGHT BE TAKEN?

The first worry is that it may foreshadow their inclusion on the FATF blacklist (formally known as list of "non-cooperative jurisdictions and high-risk jurisdictions subject to a call for action") – though that would be surprising, given that the FATF blacklist currently includes only Iran and North Korea.

The second worry is that the Cayman Islands may be included on one of the EU lists of non-cooperative jurisdictions (for tax or for AML/CTF concerns). The European Parliament in particular has been keen to expand the current list of tax non-cooperative jurisdictions. It adopted a resolution in January 2021 calling for tougher action on tax havens, including the Cayman Islands. They were also briefly listed as a non-cooperative tax jurisdiction from February to October 2020, and there is a possibility that – as a British overseas territory – they may be in a weaker position to fight being relisted due to Brexit.

If the Cayman Islands were added to the FATF blacklist, it is highly likely they would also be listed by the EU as a "high risk third country" for AML/CTF purposes[1] (the "**EU AML blacklist**"). While there is some doubt on the point, the better view is that EU and UK investors would be prohibited from investing in any instruments issued by a Cayman SSPE from the date of listing. It is unclear whether divestment would be required. Assuming they didn't have to divest, liquidity would still immediately be affected as EU and UK investors would cease to be buyers in the market for any Cayman-issued securities.

Even if FATF did not add the Cayman Islands to its blacklist, it's entirely possible that they would separately be added to the EU AML blacklist, which routinely includes many FATF greylist countries in addition to all of the FATF blacklisted countries[2]. EU investors would then be unable to invest.

Similarly, if the Cayman Islands were listed in Annex I of the EU's list of non-cooperative tax jurisdictions (the "**EU tax blacklist**"), that would have the same effect, but again only with respect to EU investors. UK investors would be unaffected. The EU tax blacklist is unlikely to be revised before the autumn.

The final possibility is that the Cayman Islands could deemed by the EU to be cooperative but nonetheless added to the EU tax greylist[3] because they have yet to deliver on commitments made to the EU to improve their implementation of tax good governance principles. If added to the EU tax greylist, investment would still be permitted, but the EU investor would be required to notify its investment in Cayman-issued securities to its home tax authorities. As with the EU tax blacklist, the EU tax greylist is unlikely to be revised before the autumn.

Needless to say, there are more general consequences of the Cayman Islands being listed on any of the FATF blacklist, the EU AML blacklist or the EU tax blacklist – including enhanced customer due diligence requirements and adverse tax consequences – that market participants would also need to consider in the event of any such listing.

CONCLUSION

It is not clear what, if any, further action will be taken against the Cayman Islands, but the mere suggestion that it might be is already causing a level of worry among UK and EU investors alike. This highlights the deficiencies in the way the rules are drafted, since it is not clear whether existing investments at the date of any blacklisting will be "grandfathered". That would seem to be the only logical approach, since any investment pre-dating a blacklisting would have been done in good faith reliance on the rules at the time.

As it is, EU investors will need to consider carefully whether to invest not only in transactions with Cayman SSPEs, but also those with SSPEs in any other country at risk of falling out of favour with the EU's tax and AML/CTF authorities. Securitisers should consider the jurisdiction of organisation of

[1] The criteria for adding to the EU list are available here: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing/eu-policy-high-risk-third-countries_en#documents
[2] FATF greylist countries currently on the EU AML blacklist include: Barbados, Cambodia, Ghana, Jamaica, Mauritius, Myanmar, Nicaragua, Pakistan, Panama, Syria, Uganda, Yemen and Zimbabwe.
[3] i.e. listed in Annex II (rather than Annex I) of the document containing the EU tax blacklist.

SSPEs they are currently forming given the timing of their transactions (including what other jurisdictions could be subject to the same or similar level of scrutiny as the Cayman Islands currently).

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