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Running to stand still: The FATF's grey-listing of the Cayman Islands

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On 25 February, the Financial Action Task Force (FATF), the global money laundering and terrorist financing watchdog, announced that it had added the Cayman Islands to its 'grey list'. This is the story of the process behind its decision.

The grey list is a list of jurisdictions that the FATF has placed under 'increased monitoring'. These countries and territories are required to resolve – or at least to struggle to resolve – strategic deficiencies that the FATF or its proxies have spotted in their anti-money-laundering and anti-terrorist-finance (AML/CTF) regimes and in their efforts to halt the financing of various nuclear weapons.

Burkina Faso, Morocco and Senegal also joined the list in February, bringing the total number of 'grey list' jurisdictions to 19 at the time of writing.

So what does an appearance on the grey list mean to the country in question? To answer that, we must first look at how the FATF assesses its member-jurisdictions through its continuous cycle of reviews, or Mutual Evaluation Reports. The review cycle that is in progress now is the fourth round of evaluations. It measures the AML efforts of member-jurisdictions against the FATF Recommendations of 2012 by applying two assessment criteria: technical compliance and effectiveness.

Technical compliance has four possible outcomes; compliant, largely compliant, partially compliant and non-compliant (C, LC, PC and NC). Effectiveness assessments also have four possible outcomes (known as effectiveness outcomes); a high level of effectiveness, a substantial level of effectiveness, a moderate level of effectiveness and a low level of effectiveness.

An evaluation is the first part of the cycle, whereby a jurisdiction assesses its AML/CFT regime against the recommendations that the FATF happens to be making at that time.

The jurisdiction then reports regularly to the FATF on progress against identified action points, either on the basis of a routine follow-up or, as in the case of the Cayman Islands, an 'enhanced' follow-up, the latter dealing with members found to have significant deficiencies in their AML/CFT systems.

Enhanced follow-up will automatically apply if the jurisdiction:

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- has eight or more non-compliant (NC) or partially compliant (PC) technical ratings;
- is rated NC or PC on at least one of the following Recommendations – 3 (money laundering offence), 5 (terrorist financing offence), 10 (customer due diligence), 11 (record-keeping) and 20 (reporting of suspicious transactions);
- has a low or moderate level of effectiveness for seven or more of the effectiveness outcomes; or
- has a low level of effectiveness for four or more of the 11 effectiveness outcomes.

In addition to the above, the FATF may also apply other 'enhanced' measures to jurisdictions placed in enhanced follow–up, particularly if it cannot see them making satisfactory progress. This does leave some room for conjecture and/or a political agenda, however.

Enhanced measures might include increases in monitoring and, in extreme circumstances, may result in the jurisdiction in question being suspended or removed entirely from FATF membership - in the 1990s Mexico once escaped this fate by only one vote.

When the FATF adds a jurisdiction to its grey list, it means that the jurisdiction has promised to resolve identified strategic deficiencies promptly and within agreed timeframes. Furthermore, it has agreed to subject itself to an increase in monitoring by the FATF or its regional FATF-style body – in the case of the Cayman Islands, this is the Caribbean Financial Action Task Force (CFATF).

Typically, jurisdictions subject to enhanced follow-up first report back to the FATF four plenary meetings after the initial report, and twice more at intervals of three plenary meetings. The FATF plenary meetings are held three times a year in February, June and October.

After three years of either regular or enhanced follow-up, jurisdictions are expected to have done something about most, if not all, of the technical compliance deficiencies identified in their reports.

After five years, irrespective of whether the jurisdiction in question was subject to regular or enhanced follow-up, a further assessment takes place in which the FATF considers the priority actions in the report and the action taken to improve the effectiveness of its regime's compliance with its recommendations.

Then...the cycle of mutual evaluations starts all over again!

This all takes a great deal of time for the FATF, the evaluation teams that belong to the regional body in question and the jurisdictions themselves in terms of the regulators, law enforcers and so on. The process of producing and reviewing documents, holding meetings and assessments, drafting reports and conducting follow-ups comes at a significant cost to the jurisdiction's economy, particularly people subject to enhanced follow-ups. It can also be expensive in terms of reputational damage and the time that it takes to rectify problems that the FATF has spotted.

Those of us who are actively involved in the AML/CFT industry have an acute appreciation of the fact that AML/CFT standards are constantly evolving in response to emerging threats and trends. Who could have

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predicted 18 months ago that a global pandemic would become a significant factor in the world of money laundering? Add to this the constant evolution of regulatory laws, tax transparency and various other changes on the horizon, and things can become unwieldy if jurisdictions, and indeed firms, fail to keep up. After all, their main jobs consist of running and developing successful economies and businesses.

This rapid pace of change adds to the problems faced by jurisdictions that are subject to enhanced follow-up, as they must not only improve themselves so as to observe current standards (and in some cases work to additional enhanced measures) but also keep one eye on the horizon to avoid being left behind. This is a never-ending task. The phrase 'running to stand still' springs to mind.

So how did the Cayman Islands find themselves in this position? In this case, the CFATF completed a mutual evaluation of the islands in November 2018 and published the report in March 2019. The report highlighted a number of findings and resulted in 13 PC ratings, albeit none in respect of the sacrosanct Recommendations 3, 5, 10, 11 or 20. This resulted in the Cayman Islands being placed under enhanced follow-up.

The first enhanced follow-up report was presented in November 2019, the second in February 2021. February's report resulted in technical compliance re-ratings and brought about a re-rating on 16 Recommendations, stating that the Cayman Islands had 'made good progress in addressing the technical compliance deficiencies identified.'

However, one re-rating – on Recommendation 15 (new technologies) – was a downgrade from largely compliant to only partially compliant. Recommendation 15 had been revised in October 2019 and the Cayman Islands were being assessed on the new version, which reinforces my earlier point about running to stand still.

In spite of the Caymans' hard work and dedication and the fact that the second enhanced follow-up found partial compliance in only one technical measure, the Cayman Islands remain subject to enhanced follow-up as seven or more of the effectiveness outcomes remain low or moderate - outcomes that were not considered as part of this second review.

In essence, it is good to have robust technical compliance controls in place, but each country must also show the FATF that it is not afraid to use them!

Furthermore, the FATF also made the decision to impose enhanced measures and therefore placed the Cayman Islands on the grey list.

The Cayman Islands responded by making a vague political commitment to work with the FATF and CFATF to strengthen the effectiveness of its AML/CFT regime. In particular, they undertook to: apply sanctions that are effective, proportionate and dissuasive; impose adequate and effective sanctions against those that do not file accurate, adequate and up-to-date beneficial ownership information; and demonstrate that they are prosecuting all types of money laundering with such prosecutions resulting in the application of dissuasive, effective, and proportionate sanctions.

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Speaking at a press conference, FATF President Dr Marcus Pleyer said that the Cayman Islands must improve 'in the area of sanctions on financial institutions for AML breaches' and that its regulators 'must show that they penalise those who do not provide accurate up-to-date beneficial ownership information.'

This means that we can expect to see more prosecutions in the Cayman Islands as their government struggles to show the world that it is not afraid to use its powers. It also reinforces what we already know about some of the FATF's current hot topics on sanctions and disclosures about beneficial ownership.

There is no doubt that these review cycles lead to better AML/CTF practice in jurisdictions. There is, however, a risk that the process might take over while we lose sight of why we are doing it all in the first place, which is ultimately to offset the bad effects of financial crime and terrorism and to promote integrity and stability in our financial markets. We must continue to remind ourselves of these fundamental objectives to ensure that the changes we make are not just about FATF approval but also represent our desire to fight financial crime.

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