Cayman Islands Trust and Corporate Service Providers - Sector Risk Assessment – January 2020 (DRAFT)

## **Introduction**

## The purpose of this Trust and Corporate Service Providers (TCSPs) Sector Risk Assessment conducted by the Cayman Islands Monetary Authority (CIMA) is to identify and assess the Money Laundering/ Terrorist Financing (“ML/TF”) risks faced by the TCSP sector in the Cayman Islands. Identifying the risks is the first step in the development and proper application of a risk-based approach to compliance and thus towards combating ML/TF.

## Under the Cayman Islands Anti-Money Laundering Regulations, TCSPs are required to take steps to identify, assess, and understand their ML/TF risks in relation to customers, geographic areas, products, services and transactions, and delivery channels; and to align all aspects of their internal controls and procedures with their risk understanding, including customer due diligence procedures, transaction monitoring systems, and the independent audit function. This sectorial risk assessment is aimed to inform TCSPs’ efforts with regards to their business wide risk assessment and the development of a risk-based approach to compliance with the Anti-Money Laundering Regulations.

## Assessing the risks within each supervised sector also enables CIMA to efficiently allocate its resources. On a national level, the TCSP Sector Risk Assessment will further enhance the Cayman Islands´ risk understanding and inform and assist policy making and supervision in the area of Anti-Money Laundering/Counter-Financing of Terrorism (“AML/CFT”).

## In addition to the data sources utilized for the 2017 Risk Assessment, a number of key data points have been analyzed and taken into account to further strengthen the quantitative elements of this TCSP Sector Risk Assessment:

## The National Risk Assessment;

## International guidance documents;

## Annual AML/CFT reporting data from TCSPS (more granular submissions);

## Supervisory judgment and expertise by CIMA staff; and

## Discussions with industry representatives and consultants.

## The process is further guided by various international guidance papers such as the *Guidance for a Risk-Based Approach for Trust and Company Service Providers* and the *National Money Laundering and Terrorist Financing Risk Assessment*[[1]](#footnote-2) and takes into account both the supervisory judgment and expertise of CIMA staff and various guidance documents issued by CIMA.[[2]](#footnote-3)

## The TCSP Sector Risk Assessment is not intended to cover risks that may be specific to the circumstances of individual entities but evaluates risks from a sectoral perspective. The TCSP Sector Risk Assessment also does not assess any types of risks other than those relating to ML or TF.

## The TCSP sectoral assessment is taken at a point in time and considers the existing activities of the entities falling under CIMA’s supervisory remit. However, given the evolving nature of ML/TF risk, the ML/TF risk assessment of inherent risk is an iterative process.

##

## **Risk Assessment Methodology**

## The TCSP Sector Risk Assessment examines the inherent ML/TF risks that the Cayman Islands’ TCSP sector faces. Inherent risk is the risk that a particular product/service, customer, delivery channel or activity poses, regardless of the TCSP that offers it and any risk mitigating controls that may be in place. This approach allows for the creation of peer groups and for the benchmarking of expected controls. The actual controls in place will vary significantly from TCSP to TCSP and are expected to be commensurate with the inherent risk that each TCSP faces.

## Risk factors in the following categories are considered for purposes of this ML/TF risk assessment:

## Nature and size of the sector

## Types of customers

## Products and services

## Delivery channels

## For each of the listed risk categories, risk increasing and decreasing factors are listed in the below table and help guide the assessment of inherent ML/TF risks.

|  |  |  |
| --- | --- | --- |
| Risk factor | Risk increasing aspects | Risk decreasing aspects |
| Nature and size of the sector  | * No physical presence
* Complexity of group structure
* Parent in high-risk jurisdiction
* Non-Cayman
* Non-regulated businesses
* Acceptance of physical cash
 | * Only Cayman originating business (local)
* Only regulated business
 |
| Types of Customers  | * PEPs
* Cash intensive
* NGOs, charities
* High risk industries
* High Net Worth individuals
* Complex corporate structures
* Hedge funds, SPVS, etc
* Customers based in/controlled or owned by persons based in high-risk jurisdictions
* Large overseas customer base
 | * Only dealing with own group
* Government clients
* Single customer
 |
| Transactions, products and services  | * Trusteeships
* Provision of registered offices
* Investment manager
* Allowing nominee companies to settle trusts
* Allowing clients to control accounts
* Nondiscretionary trust
 | * Directorships
* Investment advice
* Discretionary trust
 |
| Delivery channels  | * Non-face to face business
* Eligible introducers
* Online platforms
 | * Face-to-face onboarding
 |

## Geographical risk factors are considered in the context of each of the above categories as geography is an overarching dimension of each risk category. To allow for a structured analysis of available data according to geographic exposure, it was necessary to define the term “high risk jurisdiction.” Countries with weak or insufficient AML/CFT measures present a higher ML/TF risk as do countries associated with high degrees of bribery and corruption, tax evasion, terrorism, conflict zones and organized crime. Countries focused on for purposes of this analysis were therefore those on the FATF list of high-risk and other monitored jurisdictions,[[3]](#footnote-4) countries against which the United Nations has imposed sanctions[[4]](#footnote-5), and the first 20 countries on the Basel AML Index issued by the Basel Institute on Governance[[5]](#footnote-6).

## Per the abovementioned risk factors, each subsector of the TCSP sector has been given one of the four risk ratings ***low, medium-low, medium-high, high***. This approach is in line with the CIMA 2017 AML/CFT Sector Specific Risk Assessments.

## **Description of the TCSP Sector**

## TCSPs provide assistance in the management of their clients’ financial affairs by facilitating, through their range of services, the formation and operation of companies and trusts. As a result, TCSPs can significantly impact transactional flows through the financial system. While TCSPs are known to support and facilitate many legitimate functions, such as tax planning, they are also at risk of being misused by criminals for purposes such as concealing the ultimate beneficial owner of funds, legitimising the integration or layering of criminal proceeds within the financial system through various forms of investments. The activities of TCSPs are of a higher risk when the services are provided internationally and where the customers are based in higher risk jurisdictions. The TCSP sector’s exposure to ML/TF risk is generally considered as significant or sometimes highly significant from a global perspective

## TCSPs in the Cayman Islands are licensed and regulated by CIMA in accordance with the Banks and Trust Companies Law (BTCL) and the Companies Management Law (CML). There are three types of TSP licenses and two types of CSP licenses, with the primary distinction being the types of services that may be provided under each license. In addition, the BTCL allows for the registration of two types of trust companies:

## BTCL Licenses - TSPs:

* + Unrestricted Trust License authorizes the holder to engage in the business of acting as trustee, executor or administrator under the BTCL.
	+ Restricted Trust License authorises the holder to undertake trust business only for persons listed in any undertaking accompanying the application for the license - typically the persons listed in the undertakings are related parties, thus limiting the breadth of the licensee’s risk exposure;
	+ Nominee Trust License authorizes the holder to act solely as the nominee of a trust licensee, being the wholly owned subsidiary of that licensee. The risks associated with Nominee Trust Licences will be largely tied to those of a parent bank or trust company that is also licensed under the BTCL.
	+ Registration as Controlled Subsidiary authorizes the registrant to provide, without a license, trust services including the issuing of debt instruments or any other trust business connected with the trust business of its parent that holds a trust license.
	+ Registration as Private Trust Company authorizes the registrant to provide trust services to “connected persons”. “Connected persons” is defined in section 2(2) of the Private Trust Companies Regulations.

## CML Licenses - CSPs:

## Company Manager Licence authorizes the holder to provide corporate services as listed in Section 3(1) or any other corporate services as may be prescribed under that section.

## Corporate Service Provider License authorizes the holder to provide only the corporate services specified in Section 3(1)(a) through (e).

## As of 30 September 2019, the Fiduciary Services Division (‘FSD’) had supervisory responsibility for 144 active trust licences, comprising 57 unrestricted 58 restricted, and 29 nominee trust licenses; and 144 licenses under the Companies Management Law, comprising 120 Company Managers and 24 Corporate Service Providers. Additionally, as of 30 September 2019, there were 47 Controlled Subsidiaries and 131 Private Trust Companies Registered with the Fiduciary Services Division.

## In contrast to the banking sector in the Cayman Islands, the number of TCSPs has in recent years slightly increased. While the number of trust licensees has been slightly reduced since 2009, the number of registered controlled subsidiary and private trust companies as well as the number of licenses under the Companies Management Law have seen a steep increase during the same time period. The increase in registered controlled subsidiaries is driven largely by the speed and relative administrative ease with which parties that already hold a Trust Licence can be authorized to carry out additional trust activity that is related to the business of an existing parent company that holds a Trust Licence. The steep increase in PTCs came about because the regime was specifically created to simplify, in a cost effective manner, the provision of trusteeship to related private parties through single purpose trustee vehicles that have a statutorily mandated relationship with a company that holds a Trust Licence. Licensees under the Companies Management Law saw an increase in part because of the growth in the governance industry for the funds sector.

## The significant number of TCSPs registered in the Cayman Islands coupled with a wide array of products and services offered, the high value of cross-border transactions, the value of domestic assets and liabilities in foreign currency put the TCSP sector at the forefront of the Cayman Islands’ fight against ML and TF. In particular, the complexity of the of the services offered, the high-risk nature of the customers, and the global interconnectedness of the sector further contribute to the existing risk environment.

## Following analysis of the various sub-sectors of the TCSP sector, the TCSP Risk Assessment results in an allocation of a High rating for TSPs and a Medium High rating for CSPs. The lower risk rating for CSPs reflects the subsector’s lower customer base and number of high-risk clients from high risk jurisdictions

|  |  |
| --- | --- |
| TSPs | CSPs |
| Nature and Size: High  | Nature and Size: Medium High |
| Customers: High | Customers: Medium Low |
| Products and service: High | Products and services: Medium High |
| Delivery channel: High | Delivery channel: Medium Low |
| **Overall: High** | **Overall: Medium High** |

## **Risk Category - Nature and Size of the Sector**

## TCSPs in the Cayman Islands vary greatly in size from small entities with single customers to larger entities. There is a significant difference between the customer base of TSPs and CSPs. Customers of TSPs account for 87% of the total customer base while customers of CSPs account for 13 %. Natural persons make up approximately 40% of the customer base and corporate persons make up 60% of the customer base of the TCSP sector. In total, the TCSP sector in the Cayman Islands holds approximately 694 billion USD for its client base, 668 billion USD of which are held by TSPs and the remaining 26 billion by CSPs.

## The below chart gives an overview of the breakdown of the TCSP sector which is under the supervisory remit of FSD within CIMA. Companies Management and Corporate Service Providers fall under CSP and the remining entities fall under TSP.

## In considering the complexity of the TCSP sector, the nature of trust and company vehicles can allow vulnerabilities to ML risks. Company services involve high value transfers of assets and funds, locally and abroad. Companies and trusts may be used in sophisticated and complex transactions that span multiple jurisdictions. In addition, nominee ownership of companies can obscure true ownership and control, and ownership of trust assets and the controllers of the trust can often be obscured.

## **TSPs**

## As a subsector, TSPs include unrestricted trusts (57), restricted trusts (58) nominee trusts (29), private trust companies (131) and controlled subsidiaries (47). From an AML/CFT perspective, it is important to note the difference in the risk associated with Nominee Trust Licences and Restricted Trust Licences. Restricted Trust Licences are typically granted in respect of a single family or a small group of families for private wealth management purposes. A Nominee Trust Licence is a subsidiary of an entity that holds a Trust Licence and it provides nominee services to its parent which attracts a higher degree of risk. TSPs have 134 clients from High Risk or sanctioned jurisdictions.

## **CSPs**

## CSPs are comprised of companies that hold Companies Management Licences and companies that hold licences to act as corporate services providers. CSPs have 27 clients from High Risk or sanctioned jurisdictions.

## In assessing the risks associated with TCSPs, consideration must be given to the risk associated with the jurisdiction in which the parent company is located. Where the parent is located in a high-risk jurisdiction (as per the below table) there may be an added risk that the parent company’s AML/CFT framework and controls are weak which may subsequently result in the entity’s framework being impacted.

## **Conclusion for Risk Category Nature and Size of the Sector**

## The Cayman Islands is a developed and sophisticated international financial center, with an established international presence in the TCSP sector. While the number of TCSPs has steadily increased in recent years, an overall high risk remains for this sector due to international nature of the business catered to, the complexity of these structures, the significant number of licensees without a physical presence, and the international control and ownership structure as outlined above. Based on the above outlined factors related to nature and size of TSPS and CSPs, TSPs present a higher risk as they are more dominant with a significant number of high-risk customers.

|  |  |
| --- | --- |
| TSPs | CSPs |
| Nature and Size: High  | Nature and Size: Medium High |

## **Risk Category – Types of Customers**

## CIMA registered TCSPs serve a total of approximately 177,000 customers, 153,000 of which are serviced by TSPs and the remaining 24,000 by the CSP sector. Of the total population of customers, approximately 40% are natural persons, the remaining 60% are companies. The customer base of the sector as a whole is equally domestic (49%) and international (51%) in nature. In cases where TCSPs indicated that the customer is domestic, in practice this may include a large number of cases where the trustee is Caymanian, with the underlying beneficial owner being international.

## **TSPs**

## TSPs have the majority of customers of the whole TCSP sector in terms of absolute numbers. Approximately 153,000 customers or 87% of the total customer base of the Cayman Islands’ TCSP sector is serviced by TSPs. The percentage of natural versus legal persons customers in the TSP sector is representative of the TCSP sector in general, with about 40% of customers being natural persons, the remaining 60% legal persons.

## The number of customers translates into approximately 24,300 beneficial owners, of which approximately 3,700 (15%) come from a high-risk jurisdiction.

## The customer base of TSPs includes 1,502 PEP customers or beneficial owners, 192 of which come from a high-risk jurisdiction. 46,250 TSP customers, which accounts for about 30% of the total customer base of TSPs, are high net worth individuals, which together are holding about 12% of the assets managed by the Cayman Islands’ TSP sector. 5730 of those persons come from a high-risk jurisdiction.

## **CSPs**

## CSPs have a much lower customer base which totals 23,500 customers. However, the have a slightly lower share (34%) of natural person customers compared to the sector as a whole. As in the case of TSPs, also customers of CSPs are about 50% local and international, with about 1,700 or around 7% of all CSP customers are from a high-risk jurisdiction.

## The customer base of CSPs includes 57 PEP customers or beneficial owners, 2 of which come from a high-risk jurisdiction. 51 CSP customers, which accounts for approximately 0.2% of the total customer base of TSPs, are high net worth individuals.

## The below chart contains a comparison of the customer base of TSPs and CSPs;

## **Conclusion for Risk Category Types of Customers**

## The customer base of the TCSP sector is equally domestic and international in nature. TSPs have the vast majority of these customers (87%). A significant percentage (30%) of the total customer base of TSPs, are high net worth individuals, a number of which come from high risk jurisdictions and which together are holding about 12% of the assets managed by the Cayman Islands’ TSP sector. TSPs also have a large number of PEPs as customers who are also domiciled in high risk jurisdictions. CSPs have the remaining 13% of the customer base. A small percentage of CSP customers are from high risk jurisdictions. CSPs also have a small number of PEPs as customers, some of which are also from high risk jurisdictions.

|  |  |
| --- | --- |
| TSPs | CSPs |
| Customer: High | Customer: Medium Low |

## **Risk Category –Products and Services**

## **TSPs**

## The primary services offered by the TCSP sector consist of Administrator, Enforcer, Executor, Protector, Trustee, Director and Registered Office services.

## TSPs include Trust Licences (57), Restricted Trust Licencess (58) Nominee (Trust) Licences (29), Private Trust Companies (131) and Controlled Subsidiaries (47). From an AML/CFT perspective, it is important to note the difference in the risk associated with Nominee (Trust) Licences and Restricted Trust Licences. Restricted Trust Licences are typically granted in respect of a single family or a small group of families for private wealth management purposes. A Nominee (Trust) Licence is a subsidiary of an entity that holds a Trust Licence and it provides nominee services to its parent.

## Trust licensees, inclusive of unrestricted, restricted, and controlled subsidiaries, primarily provide general trusteeship services to various trust structures. In addition, other services include the provision of trusteeships to Unit Trusts, trusteeships to Star Trusts, and acting as protector/enforcer/executor of trust structures. Trust licensees are also permitted to provide corporate services under the Bank and Trust Companies Law (2013 Revision). Trusts can be discretionary or non-discretionary.

## The provision of trust services for TCSPs can vary from low risk to high risk, depending on the nature of the trust. Certain trusts may be considered lower risk trusts, such as those established by parents for the benefit of children or vulnerable individuals, to more complex structures, where the source of trust funds is unclear. The establishing of complex corporate structures and corporate vehicles may increase the risk of money laundering in more complex corporate structures, or where the TCSP acts or arranges for someone to act as a nominee shareholder, as the beneficial owner and true source of funds is obscured. This could facilitate the introduction of illicit proceeds of crime into the financial system.

1. The below table outlines the primary services provided by the registered entities.
2. Providing registered office or business address facilities is considered higher risk where the TCSP is not providing other TCSP services to a client (i.e. no other business relationship). This service allows the entity to maintain a physical footprint in the country, but can distance the entity from other assets and activities controlled by the beneficial owner. The lack of interaction between the TCSP and the customer may lead to a difficulty in detecting suspicious activity. Of the entities providing Registered Office services, approximately 65 of these are also engaged in the provision of other services, which goes to mitigating the risk somewhat. The service of Registered Office is overall the most dominant service in the sector.
3. Director Services may be vulnerable to exploitation for the purpose of disguising the true controllers and beneficial owners or an entity, it’s assets and transactions and as a result must be considered as potentially higher risk. 74 TSPs provide Trustee services. Trustees are required to act on behalf of the interests of the beneficiary rather than their own, which results in a risk of the entity becoming the effective legal owner of the of criminal assets and of dealing with the proceeds of crime, again increasing the ML/TF risk.

## **Value of Assets Held**

## An analysis of the assets held by clients indicate that the TSP sector far outperforms the CSP sector. In total, the TCSP sector in the Cayman Islands holds approximately 694 billion USD for its client base, 668 billion USD of which are held by TSPs and the remaining 26 billion by CSPs. Of the 694 billion USD, the vast majority namely 506 billion USD are not located in the Cayman Islands, which confirms that TCSPs in the Cayman Islands are linked with the Cayman Islands banking sector to only a limited extent. The vast share of assets held by trusts managed by Cayman Islands TCSPs are in the United States of America, followed by Switzerland and the United Kingdom of Great Britain. When compared with the value of assets held by other sectors within the financial services industry, the total assets held by TCSPs may be considered significant in value.

## The products and services engaged in by the customers of the registered entities vary from those activities which are considered low risk to very high risk. Examples of these higher risk activities are demonstrated below:

## Of the customers of registered entities engaged in potentially higher risk activities outlined above, 41 of the 457 are in high risk or sanctioned jurisdictions.

## **Conclusion for Risk Category for Products and Services**

## There is higher level of risk surrounding the services which are provided by the TCSP sector compared to other sectors given the opaqueness and the complexity which surrounds the services offered which is compounded by the cross-border nature of the business and connection to high risk jurisdictions. While many of the services which are provided by the customers of the regulated entities are low risk, there are also a number of customers engaging in very high-risk activities, with a significant portion of these activities occurring in high risk or sanctioned jurisdictions.

|  |  |
| --- | --- |
| TSPs | CSPs |
| Products and Services: High | Product and Services: Medium High |

## **Risk Category Delivery Channels**

## **Face to face**

## The delivery channels of the TCSP sector encompass face to face, non-face to face, foreign and local introducers, and also a small number of online platforms. Non-face to face business is considered higher ML/TF risk to business which is conducted in a face to face manner. The below chart contains a breakdown of those customers who were dealt with both on a face to face and non-face to face basis.

1. The above table shows the large dependency on non-face to face delivery channels for services of registered entities. 77% of TSP activity is non face to face while 62% of CSP is non face to face. A business relationship which is conducted on a non- face to face basis is considered higher risk where the client is not physically present for identification purposes. 7 CSPs accepts clients from online platforms while 2 TSPs accept clients from online platforms. Of the 9 entities that accepts clients from online platforms, this encompasses 20 relationships with high risk jurisdictions. The provision of online and virtual services makes the effectiveness of AML/CFT activities more challenging, in particular the ability for TCSPs to accurately perform CDD to identify the ultimate beneficial owner
2. Business is taken on from a number of international jurisdictions, of the 232 responses received to this question, 4 TSPs and 7 CSPs have taken on business from high risk jurisdictions.

**Outsourced activities**

1. A number of entities outsource activities internationally. The below chart breaks down the various activities outsourced by registered entities. These activities are not outsourced to high risk jurisdictions. Outsourcing of activities by TCSPs carries a risk and places an obligation on these entities to assess any parties performing services on their behalf and to maintain oversight of all outsourced activities. The chart below contains a breakdown of the activities outsourced by registered entities.

**Eligible introducers**

1. 33,400 clients of registered entities rely on introducer relationships, 32,190 of these are through relationships with lawyers, 82% of these relationships are within the TSP sub sector.
2. There are 40 relationships with introducers within the group company. 5 of these relationships are with entities in high risk jurisdictions. While using the services of a third party introducer belonging to the same group, is lower risk provided that these introducers are subject to similar AML/CFT obligations, relationships in high risk jurisdictions may be considered high risk.
3. There are 27 relationships where reliance is placed on introducers outside of the group, 2 of these relationships are with entities in high risk jurisdictions. This is also considered as being potentially high risk. Furthermore, there are 14 nominee relationships across 5 registered entities, of which one is based in a high-risk jurisdiction. Nominee services are generally considered to be higher ML/TF risk but this risk is somewhat mitigated by the fact that few of these relationships exist.

## **Conclusion for Risk Category Delivery Channels**

1. There is a large dependency on non-face to face delivery channels for both TSPs and CSPs. There is limited exposure to online platforms. Introduction within the group is common, in particular in the TSP subsector. This ML/TF risk therefore depends on the level of compliance by the group entities. The risk however is heightened by the fact that some group entities that provide introducing services are based in high risk jurisdictions. To a lesser extent, the services of introducers are used which are outside of the group. A small number of these are in high risk jurisdictions. A number of entities outsource various activities, although a somewhat mitigating factor is the fact that these actives are not outsourced to high risk jurisdictions. In such circumstances, the risk for delivery channels has been rated High for TSPs and Medium Low for CSPs.

|  |  |
| --- | --- |
| TSP | CSP |
| Delivery channel: High | Delivery channel: Medium Low |

## **Overall Conclusion**

## TCSPs have a significant global presence and jurisdictional reach in terms of customers, products and services. This exposes the sector to high risk customers and high-risk jurisdictions from an ML/TF perspective. The majority of business conducted by TCSP’s is non-face to face. This increases the ML/TF risk due to the customer not being physically present for the purposes of identification together with the challenges associated in effectively monitoring customer activity. The products and services offered by TCSPs are diverse and complex. It may also make it difficult to identify the ultimate beneficial owner and the source of funds, thus increasing the ML/TF risk. The geographically diverse customer base, and complex cross-jurisdictional ownership structures within the TCSP sector exposes the sector to a higher proportion of customers who would be classified as ‘high risk’ such as PEPs, high net worth individuals and potentially sanctioned individuals.

## The often complex legal structure of corporate customers can raise the ML/TF risk in the sector due to the lack of transparency of ownership and control associated with these complex structures. These opacities can be compounded where the customer is based in offshore jurisdictions. The delivery channels used by TCSPs to deliver their products and services to customers are equally diverse. Much of the business undertaken is non-face to face, with a high proportion of business involving introducers. Customer numbers are high and, services offered can be complex and cross jurisdictional, often involving high risk jurisdictions. The overall ML/TF risk for the TCSP sector is assessed as High.

1. <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/rba-trust-company-service-providers.html>; <http://www.fatf-gafi.org/publications/methodsandtrends/documents/nationalmoneylaunderingandterroristfinancingriskassessment.html> [↑](#footnote-ref-2)
2. <https://www.cima.ky/guidance-notes>. [↑](#footnote-ref-3)
3. <http://www.fatf-gafi.org/countries/#high-risk>. [↑](#footnote-ref-4)
4. <https://www.un.org/securitycouncil/sanctions/information> [↑](#footnote-ref-5)
5. <https://www.baselgovernance.org/basel-aml-index/public-ranking> [↑](#footnote-ref-6)