SLAUGHTER AND MAY

The UK’s approach to anti-money laundering and its impact on syndicated lending

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This article considers the key features of the UK anti-money laundering regime and its application to syndicated lending activity.

Key points

- “Know-your-customer” or “KYC” checks address financial institutions’ compliance with sanctions, as well as rules designed to combat corruption, fraud, money laundering and terrorist financing.
- The UK’s AML regime was amended in June to implement the Fourth Money Laundering Directive (2015/849) (MLD4), adding significant volume to compliance teams’ summer reading.
- The UK AML rules as amended do not deviate from the cornerstone of the pre-existing regime: financial institutions must develop their own, risk-based response to compliance. More detail on how that might be achieved has been added in certain limited areas, but the need for institutions to develop an approach that is appropriate to their business remains.
- The differing policies and requirements of each institution that flow from this risk-based approach can make KYC checks particularly time-consuming in multi-partite transactions such as syndicated loans, where each finance-side party essentially acts on its own account.

RISK-BASED CUSTOMER DUE DILIGENCE UNDER THE 2017 REGULATIONS

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the 2017 Regulations), the foundation of the UK anti-money laundering (AML) regime as applicable to financial institutions, came into force on 26 June 2017.

The 2017 Regulations repealed and replaced The Money Laundering Regulations 2007 (the 2007 Regulations), and implemented the requirements of MLD4 in the UK.

The 2017 Regulations require banks acting in the course of business in the UK to apply customer due diligence (CDD) measures when they establish a ‘business relationship’ or carry out an ‘occasional transaction’ with a customer. CDD will therefore be relevant at the inception of a customer relationship, but the institution’s obligations do not stop there. CDD must also be carried out ‘at appropriate times’ on existing customers ‘on a risk sensitive basis. Banks are therefore obliged to conduct ongoing monitoring of their customer relationships and refresh the CDD if there is a change in circumstances.

The 2017 Regulations go further than the 2007 Regulations, in that they cite a list of factors that may be taken into account in determining whether additional CDD checks are required on existing customers. These include where there is ‘an indication that the identity of the customer, or of the customer’s

beneficial owner, has changed' or 'any change in the purpose or intended nature of the relevant person's relationship with the customer'. Accordingly, it is to be anticipated that banks will build these "red flags" into their compliance processes. However, the list of factors is non-exhaustive and contains a catch-all: renewed CDD is required should there arise 'any other matter which might affect the relevant person's assessment of the money laundering or terrorist financing risk in relation to the customer'.

Accordingly, while the 2017 Regulations provide a little more guidance to banks as to when CDD is required, they do not relieve the onus on banks to carry out CDD on a "risk-sensitive" basis.

The 2017 Regulations take the same approach to the scope of CDD.

CDD involves identifying, and verifying the identity of the customer, as well as assessing and obtaining information on the purpose and intended nature of the business relationship or transaction (the requirement to assess this was not a feature of the 2007 Regulations). If an unlisted corporate customer is beneficially owned by another person, CDD must also be undertaken in relation to that customer's beneficial owner. A beneficial owner is an owner or controller of more than 25% of the customer company's shares or voting rights or who otherwise exercises control over the management of the company.

HOW SHOULD A BANK GO ABOUT SATISFYING THESE REQUIREMENTS?

The 2017 Regulations include a list of information to be obtained in the course of CDD. CDD on a body corporate, for example, will involve obtaining and verifying its name, its registration number, its registered address, and principal place of business. Banks must also take reasonable measures to determine and verify the law to which the corporate is subject, its constitution (set out in governing documents) and the names of the board of directors and its senior management (subject to an exclusion for companies listed on a regulated market).

The documentation required to satisfy those requirements is not, however, further specified, leaving institutions to consider the sorts of documentation they will accept in satisfaction of these requirements and, importantly, whether the circumstances warrant a deeper or shallower investigation.

The 2017 Regulations contemplate that in certain circumstances, Simplified Due Diligence (SDD) or Enhanced Due Diligence (EDD) might be appropriate. The Regulations set out some instances in which each might be appropriate, and in the case of EDD, some instances in which the process is mandatory (for example, when particular countries, specified by legislation, are involved). When determining what measures to take, and the extent of those measures, firms are required to take account of the Joint Guidelines issued by the European Supervisory Authorities under MLD4, issued on 26 June 2017. However the precise nature of these processes and the circumstances in which each should be adopted depends ultimately on the institution's own risk assessment.

JOINT MONEY LAUNDERING STEERING COMMITTEE'S GUIDANCE FOR FINANCIAL INSTITUTIONS (JMLSG GUIDANCE)

The JMLSG Guidance is an important influence on how UK banks approach the 2017 Regulations. It aims to 'promulgate good practice in countering money laundering and to give practical assistance in interpreting the [2017 Regulations]'. The JMLSG Guidance is not legally binding but provides an indication of the courts' and the UK supervisors' expectations and is therefore an important influence on the approach of the regulated sector to AML. It comprises general guidance for the regulated sector on the formulation of a risk-based approach plus specialist guidance for particular products and transactions. It was updated earlier this year to align its provisions with the 2017 Regulations.

The JMLSG Guidance 'sets out what is expected of firms and their staff in relation to the prevention of money laundering and terrorist financing but allows them some discretion as to how they apply the requirements…. It is not intended [to] be applied unthinkingly, as a checklist of steps to take...' In essence, it adds an important layer of colour to the statutory regime, but does not recommend an approach for all situations.

For example, Chapter 17 of Part II relates to syndicated lending. It contains guidance on who the "customers" are for CDD purposes, suggests the aspects of these types of transaction that might present the main money laundering risks and addresses when CDD should be carried out. It does not, however, distinguish between different types of syndicated lending transaction (for example, in terms of types of borrower and/or geographies) and how that might affect the scope or depth of any CDD.

FCA FINANCIAL CRIME GUIDE

The FCA's Financial Crime Guide (FCA Guide) provides an additional point of reference for FCA regulated firms (distinct from the specific FCA guidance issued earlier this year on the treatment of politically exposed persons under the 2017 Regulations). The FCA Guide does not contain rules and is non-binding. In line with the statutory framework, it is designed to be applied in a risk-sensitive, proportionate way, without detailed application provisions. This also presents difficulties, as firms must refer to another source of guidance, in particular as the FCA Guide has not been updated for the 2017 Regulations. A number of stakeholders have suggested it would be helpful to amalgamate the JMLSG Guidance and the FCA Guide to provide a single point of reference.

CDD AND SYNDICATED LENDING

As should be apparent from the brief outline above, the UK AML regime, in common with the preferred approach internationally, encourages a risk-sensitive, principles-based approach to compliance that requires thought and judgment in its application. As a result, the rules tend not to be prescriptive. Recent amendments to the UK regime to implement MLD4 include more detail on compliance with certain aspects, but in the main, any more detailed guidance tends to be by way of illustration, and the material is principles based. It is also complex, involving various sources.

This presents a particular challenge in the context of syndicated lending.

Syndicated lending, by definition involves multiple parties and very often has a cross-

border element. There are a number of "customers" to be assessed:

- Each lender party may have to carry out CDD on the borrower (or each borrower if there is more than one, which is often the case) at the outset of the transaction.
- If the primary syndicate are not party to the agreement on signing (for example, where the deal is underwritten by a smaller group of lenders), the arranging or underwriting banks will need to carry out CDD on the lenders to whom they are selling their initial commitments.
- The facility agent (and any other administrative parties, for example, the security agent on a secured transaction) will need to complete its own CDD on the other parties to the agreement both on the lender and the borrower side.
- It is also normal practice for the lender-side parties to carry out CDD on any guarantors of the borrower(s)' obligations at the outset of the transaction, notwithstanding the indication in the JMLSG Guidance that the same could await such time as the guarantee is called.

A less than streamlined set of requirements potentially complicates the process quite considerably, in particular in relation to the borrower parties, where multiple lending banks are trying to complete KYC on the same customer (the borrowers and guarantors under the facility) at the same time. While borrowers might recognise that divergent requests are reflective of the underlying legislative regime, compliance with multiple finance parties' (reasonable) requirements can be challenging to manage. It is not unknown for KYC to take weeks, and execution teams often have little ability to speed up the process.

The CDD process for a syndicated loan is also complicated by the fact that such facilities are designed to accommodate the introduction and departure of parties on both the lender and the borrower side during their term. CDD must be considered each time a new borrower or guarantor accedes to the facility and as participations in the loan are traded on the secondary market.

Initial CDD (on both lender-side and borrower-side parties) should be dealt with before signing. The LMA's templates oblige the obligors to provide any information required to facilitate compliance with KYC requirements during the course of the transaction. The accession of new borrowers or guarantors after signing is subject (among other things) to the prompt provision of any documentation reasonably requested by the finance-side parties to enable them to carry out and be satisfied they have complied with all necessary KYC or similar checks under all applicable laws and regulations.

The same documentation must be provided on request if there is a change in law necessitating new checks, if there is a change in status of any obligor or its parent holding company (reflecting the requirements of the 2017 Regulations) or if a new lender joins the syndicate.

CDD can present a particular headache for lenders wishing to trade their participation. Selling lenders must consider CDD in relation to the incoming lender, and, if the incoming lender is to become a lender of record, CDD in relation to the obligors is relevant.

The KYC process is frequently cited as a key factor driving the unsatisfactory length of

settlement times in the European secondary loan market.

RISK VS RULES

A risk-based regulatory framework has many benefits. It is arguably easier to draft and has greater ability to withstand market adaptations.

The sheer multiplicity of circumstances that might need to be addressed in the context of AML militates against the provision of checklists at a regulatory level. However, as noted above a risk-based approach does mean that the approach that emerges may not be entirely consistent from bank to bank, and even less so from country to country.

The most obvious way to fill the gap is to develop influential and widely adopted guidance. The JMLSG Guidance goes some way towards levelling the playing field, but in practice, differences in approach do arise, both in terms of documentation requirements and as regards the scope of CDD and the level of information required. In the syndicated loan market these are particularly apparent for the reasons described above and the most recent update of the JMLSG Guidance, being limited to MLD4, did not result in any amendments to the relevant Chapter 17 of Part II that seem likely to improve matters materially. It is notable that in response to market demand, the Loans Syndication and Trading Association, the trade body for the syndicated loan market in the US published some KYC Considerations for the US loan market in January 2016. These focus primarily on the application of CDD to the range of counterparty relationships arising on a syndicated loan, although more comprehensively than the JMLSG Guidance.

The LMA notes certain areas in which Chapter 17 might usefully be expanded in its response to the JMLSG's consultation that preceded the 2017 revisions to the Guidance. These include that certain "sub-groups" of the syndicated loan market will have more or less exposure to money laundering risk – for example, loans made to borrowers in emerging markets compared with loans made to an investment grade corporate in a developed market.

The LMA suggests that the Guidance could be divided into sub-groups or case studies to offer greater clarity on the need for lesser/greater assessment depending on the different risks inherent to certain geographies or types of borrower/lender.

It would no doubt be welcomed by lenders and borrowers if the JMLSG Guidance could be expanded to address this and other issues going forward.

Further Reading:

- The new Anti-Laundering Directive: the law moves on (2017) 1 JIBFL 30.
- Full speed ahead on the Fourth Anti-Money Laundering Directive (2016) 4 JIBFL 256.
- LexisNexis Loan Ranger blog: Tackling settlement delays in the LMA secondary loan market.

This article was written by Kathrine Meloni, special adviser and Selmin Hakki, professional support lawyer at Slaughter and May. It first appeared in Butterworths Journal of International Banking and Financial Law in November 2017.

Kathrine Meloni
T +44 (0)20 7090 3491
E kathrine.meloni@slaughterandmay.com

Selmin Hakki
T +44 (0)20 7090 5153
E selmin.hakki@slaughterandmay.com

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