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2 June 2016

RESPONSE TO BE SENT VIA EMAIL

Dear Sirs,

Response to HM Treasury's Call for Information: Anti-Money Laundering Supervisory Regime (the Consultation)

The Loan Market Association (**LMA**) welcomes the opportunity to respond to the Consultation published on 21 April 2016 and hopes that its comments will be useful in HM Treasury's examination of options to improve the anti-money laundering (**AML**) and counter-terrorist financing (**CTF**) regime.

The LMA is the trade body for the European, Middle Eastern and African syndicated loan markets. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 600 organisations across EMEA and consists of banks, non-bank investors, borrowers, law firms, rating agencies and service providers.

Introduction

The purpose of this Consultation is to identify options to improve and strengthen the AML and CTF regime, thus making the regime more effective while reducing those regulatory burdens that do not effectively contribute to tackling money laundering (**ML**) or terrorist financing (**TF**).

The Government wishes to promote, and entrench, a "risk-based approach" to combating ML and TF, requiring banks and other firms to adopt an approach whereby they identify, assess and understand the ML/TF risks to which they are exposed, and agree AML and CTF measures that are proportionate to those risks.

We very much welcome HM Treasury's desire for "the banks and other firms subject to the Money Laundering Regulations to take a proportionate approach, focusing their efforts on the highest risks, without troubling low risk clients with unnecessary red-tape."[1] However, the current regulatory burden on businesses, coupled with inconsistencies in the AML/CTF guidelines, contributes to an inefficient and less effective AML/CTF regime. We provided specific examples of inefficiencies caused by the inconsistent AML/CTF regime in our recent response to the Joint Committee of the European Supervisory Authorities Consultation Paper: Joint Guidelines under Article 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence, and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions. We enclose a copy for your information.

[1] HM Treasury's Action Plan for anti-money laundering and counter-terrorist finance, April 2016.

Having consulted with our members in relation to the Consultation, we would like to respond to the following questions:

Identification of Risks

Question 1: Should the government address the issue of non-comparable risk assessment methodologies and if so, how? Should it work with supervisors to develop a single methodology, with appropriate sector-specific modifications?

Inconsistencies in methodology, potentially leading to two supervisors viewing the same business type as having materially different risks, leads to uncertainty and inefficient use of resources in the market, especially for institutions active across numerous jurisdictions and sectors. This can also lead to the imposition of needless bureaucracy on low risk businesses.

A single methodology, suitably tailored for individual sectors, would therefore be welcome, as it would create consistency and certainty in the market, allowing firms to better focus resources on (potential) serious crime. However, specific care should be given to ensure that tailored methodologies do not indirectly impact multiple sectors, as this would create more inconsistencies in the market.

Government should also seek to ensure transparency as to supervisors' expectations on how the methodology is to be applied.

Penalties and Enforcement

Question 10: Should the government seek to harmonise approaches to penalties and powers? For example, should supervisors have access to a certain minimum range of penalties and powers and what should these be? Should there be a common approach for deciding penalties and calculating fines based on variables such as turnover that are scalable to the size of the business?

Certainty of approach is vital to the development of an efficient market and an effective allocation of resources. The range of powers should be proportionate to the respective failure and should dissuade non-compliance.

However, government should be mindful of the impact on the financial sector of making ML and TF a criminal offence in all but the most obvious situations (i.e. where the compliance officer has acted negligently). Otherwise, the lack of certainty and clarity regarding AML/CTF guidelines (discussed at questions 19 to 21 below), could result in senior officers refusing to continue in compliance roles due to the threat of a criminal penalty should they misinterpret one set of guidelines incorrectly. This could also result in the industry's most experienced personnel leaving the market, resulting in a knowledge gap that cannot be easily filled, thus making it harder for institutions to effectively tackle potential ML or TF going forward.

Ensuring high standards in supervised populations

Question 14: Is there a need for supervisors themselves to undergo training and/or continuous professional development? If so, what form might this take and should it be government-recognised?

We strongly support the idea that supervisors undergo training and continuous professional development, not only in relation to the AML/CTF regime, but in the regime's application to individual products, geographies and sectors. Failure to have a sound knowledge of these aspects will hinder the development of a clear and effective regime.

For example, in the financial sector, supervisors should have a sound knowledge of the different financial products available, the sectors and geographies in which they are used, the nature of the counterparties, the importance of those products to the wider economy, and how they interplay with the AML/CTF regime on a practical level at each stage of a transaction. In syndicated lending, for example, there are a wide number of situations in which AML/CFT requirements can potentially arise during the course of a syndicated loan transaction (see enclosure for full details). Having a sound knowledge of the product will assist supervisors in understanding how the product could fall prey to potential ML or TF risks, without imposing unnecessary compliance burdens. Supervisors will then be able to ensure that resources are dedicated to those areas at actual, rather than theoretical, risk.

Training and/or continuous professional development should therefore be two-fold – firstly keeping track of developments in the AML/CTF regime (both in the UK and globally), and secondly, in its practical application. We do not believe such training need be government-recognised, provided an appropriate programme is in place.

Guidance

Question 19: How could inconsistencies between the JMLSG guidance and the FCA's Financial Crime Guide best be resolved? Should the two be merged? Or should one be discontinued and if so, which one and why?

We would support a proposal to merge the JMLSG guidance and the FCA's Financial Crime Guide. This process would highlight areas of inconsistency, allowing for resolution going forward. However, due to the subjective nature of the risk-based approach to combating ML and TF, any project to produce a consolidated piece of guidance should be carried out in collaboration with industry professionals. Not only are they best placed to offer practical examples on how current guidance is being interpreted (and see whether this accords with the regulators' intent) but they will also be able to highlight those areas for which the guidance is unclear. Regulators occasionally focus too much on the procedural aspects to a transaction, as opposed to the practical, and it will only be by marrying the two aspects together that ML and TF will be tackled effectively.

Question 20: What alternative system for approving guidance should be considered and what should the government's role be? Is it important to maintain the principle of providing legal safe harbour to businesses that follow the guidance?

Supervisors should seek to collaborate with one another to ensure consistency of guidance. They should also seek to engage in direct dialogue with the banking industry, to discuss how better alignment can be achieved in relation to AML/CTF.

Government should also engage with global regulators to ensure better alignment of the AML regime internationally. ML and TF are <u>global</u> threats, and institutions operating across jurisdictions and on cross-border transactions regularly find themselves dedicating resources to understanding the jurisdictional idiosyncrasies of their counterparts, as opposed to focusing on those areas where ML poses the greatest threat. The implementation of AML/CFT

measures, with the benefit of global consensus, will therefore help avoid regulatory arbitrage and prevent confusion within the financial markets, allowing the effective allocation of resources to where they are most needed.

Question 21: Should the government produce a single piece of guidance to help regulated businesses understand the intent and meaning of the Money Laundering Regulations, leaving the supervisors and industry bodies to issue specific guidance on how different sectors can comply? If so, would this industry guidance need to be Treasury approved? Should it be made clear that the supervised population is to follow the industry guidance?

We strongly support the proposal that the government produce a single piece of guidance to help regulated businesses, and businesses generally, understand the intent and meaning of the Money Laundering Regulations. Specific Treasury approved guidance on how different sectors can comply should then be left to one dedicated supervisor, rather than different industry bodies. Having separate supervisors tackle different aspects of the regime, will, in our view, lead to potential for uncertainty and inconsistency, particularly for those institutions active across different sectors and products. Similarly, encouraging industry bodies to publish such guidance is, in our view, inappropriate. This is simply on the basis that if it turns out to be misguided or is subsequently misinterpreted by the industry it is seeking to assist, the body is unfairly exposed to prosecution. It also results in risk being incorrectly allocated and effectively transferred from the institution undertaking the activity, to the industry body issuing the guidance, which is clearly not its role. We would therefore argue that it is the role of one dedicated supervisor to provide specific guidance to the industry as a whole.

In addition, because it may be difficult to cover off the idiosyncrasies of every individual financial product, sector and non-EU jurisdiction in which financial institutions operate within one piece of guidance, it would also be worthwhile if institutions could "sense check" or pre-authorise their ML and TF processes with one supervisory body, particularly in those situations when the usual requirements are not easily satisfied. If such pre-authorisation was possible, then firms would be less likely to impose unnecessarily burdensome/impractical requirements on their low risk customers.

In any event, the Treasury should seek to work with regulators and industry bodies in putting any such guidance together. In addition, it would be useful if such guidance could include a chapter on how the Money Laundering Regulations interplay with the additional pieces of legislation in this area, i.e. the Proceeds of Crime Act 2002 and the Terrorism Act 2000. If necessary, such legislation should be reconciled.

Ensuring the effectiveness of the FCA

Question 28: How can credit and financial institutions best be encouraged to take a proportionate approach to their relationships with customers and avoid creating burdensome requirements not strictly required by the regulations?

Producing a single, clear, objective piece of guidance would be the best way to avoid credit and financial institutions creating overly burdensome requirements, which may not strictly be required by the regulations. The current lack of certainty, together with the potential criminal liability for breaching AML and/or CTF legislation, means firms are taking an exceptionally risk averse approach to satisfying their obligations. Coupled with the subjective nature of the

risk-based approach to combating ML and TF, customers may often find themselves having to supply different versions of the same document to satisfy each credit/financial institution's internal requirements.

For example, for syndicated loans, different lending entities each have different requirements for (i) how a corporate's structure chart should be certified, whether that be by the company director, company secretary or by legal counsel; (ii) FATCA documentation, requiring borrowers to document the same information in various forms; and (iii) disclosure levels for identifying a borrower's beneficial owner(s). The lack of a common standard therefore requires the borrowing group to expend too much time providing tailored documentation than would be the case were they able to comply with a common standard, resulting in a misallocation of resources. It addition, requirements will differ between different lenders based in different jurisdictions, as a result of them having to comply with different national regimes. Furthermore, some lenders will be required to comply with more than one national regime, e.g. a Spanish bank advancing a loan from a UK branch, with offices in both European jurisdictions having to follow a different set of guidelines and rules. Customers will therefore have to comply with additional requirements in such instances. This may be further complicated when borrowers are situated outside the EU, on the basis that the documents they are required to provide may not even exist (e.g. utility bills). This is particularly prevalent when lending to emerging markets.

If a well-researched, detailed and objective piece of guidance could be produced, regulatory and/or industry bodies would then be able to provide greater education on the AML/CTF regime to all market participants. This would help credit and financial institutions have a clearer idea of their requirements, which they, in turn, can communicate to their clients.

Conclusion

To date, the process of satisfying unclear, and often inconsistent, AML and CFT obligations has been expensive, time consuming and onerous on all parties to a transaction. It would therefore be of enormous assistance to the market if more could be done to achieve greater alignment, allowing banks and other firms to focus their efforts on the highest risks, without troubling low risk clients with unnecessary red-tape.

We very much support HM Treasury's work in this area and would be happy to discuss any aspect of this response with you in more detail and to meet with you as required. If we can be of any further assistance, please do not hesitate to contact either Nicholas Voisey or Nigel Houghton via email at nicholas.voisey@lma.eu.com / nigel.houghton@lma.eu.com or by telephone on +44 (0) 207 006 5364 / +44 (0) 207 006 1207.

Yours sincerely

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Enc: LMA response to the Joint Committee of the European Supervisory Authorities Consultation Paper: Joint Guidelines under Article 17 and 18(4) of Directive (EU) 2015/849

on simplified and enhanced customer due diligence, and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions.