

18 January 2016

**RESPONSE TO BE SENT VIA ONLINE
QUESTIONNAIRE**

Dear Sirs,

Response to the Joint Committee of the European Supervisory Authorities ("ESA") 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 (the "Consultation")

The Loan Market Association ("LMA") welcomes the opportunity to respond to the Consultation published on 21 October 2015 and hopes that its comments will be useful in the ESA's upcoming review.

The LMA is the trade body for the European syndicated loan market. 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 Consultation has as its objective to set out the risk factors that credit and financial institutions ("Firms") are required to consider, in order to assess the risk of money laundering ("ML") and the financing of terrorism ("TF") that can potentially arise either in individual business relationships or the occasional transaction.

The proposed Guidelines require Firms to take their own "risk-based approach" to ML and TF (i.e. they must adopt an approach whereby they identify, assess and understand the ML/TF risks to which they are exposed, and agree anti-money laundering ("AML") and counter-terrorist financing ("CFT") measures that are proportionate to those risks). In addition, the Guidelines emphasise that the factors and measures described therein "are not exhaustive" and that Firms should "consider other factors and measures as appropriate". At the same time, however, the Guidelines state that there is not "an expectation that firms should consider all risk factors in all cases".

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

Do you consider that these guidelines are conducive to firms adopting risk-based, proportionate and effective AML/CFT policies and procedures in line with the requirements set out in Directive (EU) 2015/849?

Given the broad spectrum of situations in which AML or CFT could potentially be applicable, we understand the rationale for ensuring that the Guidelines are not overly prescriptive with regards to the factors that should be considered to assess and manage ML/TF risk. That said, requiring institutions to take an entirely subjective approach can actually lead to drastically different interpretations of risk. This creates particular problems for those financial transactions where more than one Firm is a party, leading to large amounts of confusion and delay, often at the expense of legitimate business customers, and without any obvious improvement to combating the fight against ML and TF. It is with regards to transactions of this nature, specifically syndicated lending, that we would like to draw the attention of the ESA, and recommend that greater consideration be given as to how best to coordinate risk assessments between different Firms party to the same transaction, and thereby reduce inefficiencies in the market.

Background to AML and syndicated loans

A syndicated loan facility may be a term loan, a revolving loan, a standby letter of credit facility, a guarantee facility or some other similar arrangement. In each case, it involves two or more lenders contracting to provide credit to a particular corporate or group. Under a syndicated loan, the borrower will typically appoint one or more lenders as "arranger(s)" which will then proceed to sell down parts of the loan to the other lenders, whilst retaining a proportion of the loan itself/themselves. The arrangement is put together under one set of terms and conditions usually following LMA recommended form template loan documentation, but each institution's liability is limited to the amount of its participation. As a result, the syndicated loan market facilitates the sharing of credit risk, and it is therefore possible for a large number of investors to participate in facilities of various amounts, well in excess of the credit appetite of a single lender.

To facilitate the process of administering the loan on a daily basis, one bank from the syndicate will be appointed as facility agent, acting on behalf of the other lenders. The agent has a number of important functions, including the transfer of funds advanced by the lenders to the borrower, the transfer of all interest, principal and other fees payable by the borrower under the loan agreement to the lenders, acting as the point of contact for the borrower (and the lenders), monitoring the borrower's compliance with the terms of the facility agreement and taking receipt of all notices, compliance certificates and other information from the borrower (and distributing it to the lenders).

As a result of there being numerous lenders involved in the process (many of which will be credit and financial institutions) as well as a facility agent, there will be a need for such institutions to conduct their own risk assessments relating to AML/CFT. In a syndicated loan context, the customer due diligence aspects of such assessment is known as "know your customer" or "KYC".

During the life of a syndicated loan transaction, there are likely to be various points at which lenders/the agent will be required to undertake KYC. For example:

- at the outset of a syndicated loan transaction:

- the arranging banks (the "Arrangers") will undertake KYC in relation to the borrower(s) of the loan (the "Borrower(s)"), as well as any guarantors guaranteeing the facility (each a "Guarantor");
 - the Arrangers will undertake KYC in relation to any other lender participating in the facility (each a "Lender"), to which the Arrangers will "sell down" the loan; and
 - the facility agent ("Facility Agent"), on its own behalf but not for the other lenders in the syndicate, will undertake KYC in relation to the Arrangers, any Lender, the Borrower(s) and the Guarantors.
- During the life of the syndicated loan:
 - any additional corporates that accede to the facility agreement as Borrowers or Guarantors will need to satisfy the KYC requirements of all Lenders and the Facility Agent;
 - any proposed assignment or transfer by a Lender of any of its rights and obligations under the facility agreement to a party that is not a Lender prior to such assignment or transfer (a "New Lender") will need to satisfy the KYC requirements of both the Lender assigning/transferring its rights and the Facility Agent; and
 - any new Lender participating in the facility agreement will be required to undertake KYC in relation to the Borrower(s), any Guarantor(s) and the Facility Agent.

Practical issues arising from risk-based approach to AML and CFT

Given the wide number of situations in which AML/CFT requirements can potentially arise during the course of a syndicated loan transaction, numerous practical difficulties can arise. This often results in what we consider to be unnecessary confusion and delay for all parties involved. These difficulties may be seen to be a direct result of the use of the risk-based subjective assessment approach recommended under the Guidelines, simply because different Firms will assess risk in different ways. Whilst the differences may not be obvious in terms of underlying rationale (and the result is likely to be the same) they can differ drastically in terms of the documentation/evidential requirements needed to satisfy them, resulting in what is ultimately an unnecessary administrative burden and cost for both the party having to supply the information and the party having to review the information and chase for anything outstanding and/or missing.

To provide further clarification, some of the practical issues that can arise during the KYC process in the context of a syndicated loan transaction include:

- A Borrower under a loan could potentially be required to supply different versions of the same document to satisfy each Lender's internal requirements. For example, different lending entities each have different (i) requirements for 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 requirements, 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 common standard therefore requires the Borrowing group to expend more time providing tailored documentation than would be the case were they able to comply with a common standard.

- The requirements of each Lender could change whenever its internal policy is reviewed. As a result, an acceding Borrower to a facility agreement could be required to provide different information to that supplied by the original Borrower.
- 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 each European jurisdiction having to follow a different set of national guidelines and rules.
- Requirements could differ between different products even for the same corporate as a result of there being different KYC departments within individual institutions.
- Underwriters can experience delay in completing the sell-down/primary syndication process due to ongoing KYC issues. This will likely have balance sheet implications for the underwriters, with the asset remaining on their balance sheet for longer than anticipated. Delays can also lead to revenue shortfalls for any incoming lenders who have allocated capital to support their commitment, but are receiving no revenue until such time as KYC is complete and they become a lender of record.

In addition, in its 2014 revised guidance for the UK financial sector as to the prevention of money laundering/combating terrorist financing, the Joint Money Laundering Steering Group, at section 17.8, considered "The Agent's customers are the Borrower and the Lenders". As a result of this guidance, institutions that perform the role of Facility Agent may be unable to recognise a distinction between new lenders in syndicated transactions and actual new clients (e.g. those that enter bilaterally into a full range of banking transactions with that institution). Consequently, said institution may apply an identical KYC process for new lenders as it does for actual new clients. This is invariably time consuming, complex and very challenging for new lenders who simply wish to transfer into a syndicated transaction and have no other relationship with the Facility Agent. Furthermore, the delay created by the continually shifting KYC landscape can provide a perception of inefficiency, which is damaging to the loan market as a whole and could have an impact on liquidity.

Borrower's ultimately want certainty of, and visibility into, the syndicate lenders. This is compromised by open trades where settlement is delayed due to KYC challenges. As a result of this, and the above, we would urge the ESA to consider whether a more uniform approach to AML and CFT requirements would be beneficial, particularly for those transactions such as syndicated loans which require a large number of independent parties to undertake their own assessment of risk in relation to the same underlying entity. In particular, our recommendations would be:

- to set up an advisory body or similar entity to enable groups of institutions to consider and agree a core set of requirements for transactions such as syndicated loans, where more than one party to the transaction is required to assess the risk relating to the same counterparty;
- for European and national regulators to engage in direct dialogue with the banking industry, to discuss how better alignment can be achieved in relation to AML/CTF;

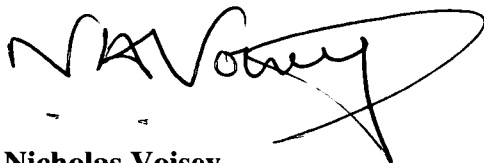
- to implement AML/CFT measures with the benefit of global consensus to avoid regulatory arbitrage and to prevent confusion within the financial markets; and
- to achieve much greater consistency in AML/CTF regulation and supervision between different products.

Conclusion

The process of satisfying AML and CFT requirements in the context of syndicated loan transactions is expensive, time consuming and onerous, as evidenced by the time and resources dedicated to the satisfaction of requirements by both lenders and corporates. It would therefore be of enormous assistance to the market if more could be done to achieve greater alignment, particularly when a risk assessment is being undertaken by several institutions in relation to the same entity (and pertaining to the same transaction). Greater consistency of approach between different institutions would undoubtedly improve liquidity in the syndicated loan market by improving efficiencies and lightening the administrative burden for borrowers, ultimately enabling them to receive funds for legitimate business purposes in a timely manner and without, we believe, having a detrimental impact on the fight against money laundering and terrorist financing.

We 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 me via email at nicholas.voisey@lma.eu.com or by telephone on + 44 (0)20 7006 5364.

Yours sincerely



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