Loan
Market
Association
the authoritative voice
of the EMEA market

10 Upper Bank Street
London E14 5JJ
Tel. +44 (0)20 7006 6007
Fax +44 (0)20 7006 3423
lma@lma.eu.com
www.lma.eu.com

10 June 2019

Sent via email:

Anti-MoneyLaunderingBranch@hmtreasury.gov.uk

Dear Sirs

Representations relating to the Transposition of the Fifth Money Laundering Directive ("MLD 5") Consultation ("Consultation")

We write to you further to our previous correspondence and, in particular, our meetings with Mark Frost on 10 November 2017 and Miriam Paracha on 26 June 2018, as well as our letter to, and meeting with, Jonny Medland and other Treasury representatives on 28 September and 5 November 2018 respectively. This letter is intended to express our ongoing concerns in relation to the detrimental impact on the syndicated loan market of the beneficial ownership of trust provisions contained in Article 31 of MLD 5, as set out in Chapter 9 of the Consultation, as well as various other matters.

We would respectfully request that our representations in this regard be considered when revisions are made to the underlying legislation prior to transposition of MLD 5 into UK law. We would also be happy to meet with you again to discuss potential solutions to the issues raised.

Summary

The fight against money laundering and terrorist financing is of fundamental importance to the members of the Loan Market Association (the "**LMA**")[1], who recognise the positive legislative intention of both MLD 5 and the UK Money Laundering Regulations ("**MLR**"). Above all, we strongly support the underlying objectives of both pieces of legislation, in

[1] The LMA is the trade body for the EMEA syndicated loan market and was founded in December 1996 by banks operating in that 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 700 across more than 60 nationalities and consists of banks, non-bank investors, law firms, rating agencies and service providers. The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the European loan market vis à vis lenders, borrowers, regulators and other interested parties.

particular, the need to obtain greater transparency on issues such as beneficial ownership. However, there are certain provisions contained in MLD 5 which, as outlined at our earlier meetings, are likely to have an unnecessarily detrimental impact on the functioning of the primary and secondary syndicated loan market[2], as well as corporate loan market liquidity more generally, without resolving the issues they are purporting to address.

We are therefore grateful for the confirmation provided at the meeting on 5 November 2018 that you are amenable to hearing our representations in this regard. We hope that these representations will be useful in shaping the debate as any revisions to the MLR make their way through the legislative process.

Chapter 9 - trust registration service provisions (Questions 70, 72 and 73)

We would like to draw Treasury's attention to the revised sections of MLD 5 (specifically Article 31), which relate to the disclosure of information on the beneficial ownership of trusts (attached at Annex II to this letter). We note that MLD 5 now extends the registration obligation to the trustees of all express trusts, regardless of whether they have taxable consequences (this being the position under the existing legislation). Furthermore, MLD 5 does not contain any "grandfathering" provisions in relation to existing trusts, meaning that, when the UK implements Article 31 of MLD 5, trustees will need to register beneficial ownership information on all existing express trusts, as well as any new express trusts created after the legislation comes into effect. Given that the trust structure is extensively used in the UK (e.g. for individual and collective investment and wealth planning, structuring transactions, creating security interests, effecting subordination arrangements and various charitable purposes) in the absence of any grandfathering provisions, there will be a huge number of trusts requiring registration in a fairly short period of time.

Consequently, we believe that Article 31 of MLD 5 is not only fundamentally unworkable, but also of little practical benefit to competent authorities, FIUs, obliged entities or anyone else who may have a legitimate interest in such information. This issue is particularly relevant to the UK, given the very wide and long-established usage of trusts by the legal sector as compared to other European jurisdictions. It is also important to emphasise from the outset that the majority of trusts created under English law are not set up for the purpose of owning assets or the channelling of funds, but for other purposes, the rationale for which is simply to facilitate transparent transactions. This means that they are used either to hold assets on behalf of specified beneficiaries or classes of beneficiaries or hold security interests on behalf of a group of beneficiaries who have taken security over particular assets owned by a third party (usually as a condition to providing financing to that third party). They also enable such rights and interests to be transferred easily from one beneficiary to another. Putting these types of trust into a beneficial ownership regime which requires disclosure of all relevant parties on a central register, even though they do not generate tax consequences, will result in severe disruption to corporate and retail activities that use these structures on a daily basis.

The role of trusts and syndicated loans

---

[2] For more details on syndicated lending, please see Annex 1.

Although some syndicated loan facilities are unsecured (particularly when such loans are extended to better quality investment grade borrowers) the majority of mid-market, M&A, real estate, asset finance and project finance syndicated lending is, in some way, secured against some or all of the borrower's assets.

If the syndicated loan is to be secured, a lender from the syndicate (or the Agent) will usually be appointed to act as a Security Trustee, to hold the security on trust for the benefit of a defined class of beneficiaries (i.e. the lenders or the finance parties), as follows:

The objective of this arrangement is to ensure that: (1) a single entity is responsible for the administrative aspects of the security (such as holding title deeds and other documents relating to the charged property) and for making distributions to the secured lenders on enforcement (i.e. when a borrower defaults on its loan repayments, the loan is accelerated and the secured assets are sold to repay the loan); and (2) where a lender assigns or transfers its interest to another entity, the new lender will benefit from the existing security package, without the need for the security to be re-registered or for new security to be granted. This enables the lenders within a syndicate to fluctuate freely, as new lenders join and existing lenders transfer part of all of their interest in the loan.

If Security Trustees are, going forward, required to disclose the identity of all beneficiaries to a security trust (and also register existing trusts) huge investment will be required in systems, processes and manpower to enable Security Trustees to pass daily updates of changes in each and every identified beneficiary to the register, even if they have only a trivial interest under the trust. This will be a particular burden where there are frequent changes in identified beneficiaries. For example, in the context of a secured syndicated loan, the Security Trustee will hold any assets pledged by the borrower as security for the loan on trust for the benefit of all the lenders in the syndicate. One of the benefits of this arrangement is to ensure that, when a lender assigns or transfers its interest in the loan to another entity, the new lender will benefit from the existing security package, without the need for the security to be re-registered or for new security to be granted. However, MLD 5 would require the trustee of that security trust to update the register each and every time the loan is traded (which for certain loans will take place very frequently) which seems unnecessarily onerous, particularly given that the information provided would be of no relevance whatsoever to the supervisory authorities.

Furthermore, given the nature of syndicated lending (i.e. the fact that it consists of a number of institutions contracting together under the same set of terms and conditions to provide credit to a particular borrower or corporate group) even in unsecured transactions where there is no security and no security trustee in the structure, there are still very likely to be trust provisions contained within the underlying loan agreement, or at least "other types of legal arrangements...similar to trusts" which could trigger a registration obligation. For example, whilst unsecured transactions do not require borrowers to provide security as a condition for receiving the loan, there will, more often than not, be guarantee provisions by which guarantors guarantee the obligations of the borrower. These provisions also contain trust

arrangements – for example, standard wording contained in the LMA investment grade documents states the following:

"If a Guarantor receives any benefit, payment or distribution in relation to such rights it shall hold that benefit, payment or distribution to the extent necessary to enable all amounts which may be or become payable to the Finance Parties by the Obligors under or in connection with the Finance Documents to be repaid in full ***on trust*** *for the Finance Parties and shall promptly pay or transfer the same to the Agent or as the Agent may direct for application in accordance with Clause [ ] (Payment mechanics)."*

This would lead to the conclusion that all syndicated loan agreements (and possibly all bilateral loan agreements with guarantor or other types of turnover arrangement) will contain some kind of trust provision. This will mean, especially given the lack of grandfathering arrangements, that hundreds of thousands of trusts will need to be registered within a fairly short space of time in order to satisfy the legislative requirements.

Finally, given that loan agreements are private contracts between the lenders and the Borrower, there is a danger that in some cases, disclosure of the existence of a trust could result in commercially confidential information being released into the public domain.

In conclusion, we accept that Treasury is currently obliged to transpose MLD 5 by the end of 2020 and that it does not have huge flexibility to make substantive changes to the wording or the requirements of the Directive. However, we would ask that consideration at the very least be given as to how disclosure of information in relation to beneficial owners of security trusts, which do not generate taxable consequences and which do not permit either asset ownership or the channelling or transfer of funds, be dealt with. For example, we wondered whether Treasury could consider expanding the use of the "class of beneficiaries" concept to expressly include those who are beneficiaries under a security trust, to enable all secured beneficiaries to that security arrangement to fall within the same class. In the context of a security trust under a syndicated loan, this would simply be the "finance parties, from time to time". Finally, it would be helpful if Treasury could give consideration as to whether they have the ability to extend the grandfathering arrangements for pre-existing arrangements past 31 March 2021, or at least suggest a phased approach to implementation whereby trusts that do not generate taxable consequences but which have at least been set up to physically hold assets at the point they are created (as opposed to holding security interests or assets at a future point in time) are registered first.

Other matters

With regards to other matters raised as part of the Consultation, we had the following additional observations:

Chapter 4 – Customer due diligence – Question 45

Whilst it may be helpful in certain situations that HMT does not propose making formal recognition of electronic identification schemes a prerequisite for use (e.g. in instances where such guidance exists already and is widely relied upon), the general concept of "implicit recognition" via Treasury approved guidance is not always as useful as it sounds, particularly

for industries such as syndicated lending where multiple obliged entities must all sign off their customer due diligence ("**CDD**") requirements in respect of the same borrower or borrowing group. This is down to the simple reason that different banks frequently interpret requirements in very different ways (and some may be more willing to rely on "implicit recognition" than others. We would therefore suggest that it would be far more useful if, in the future, Treasury would agree to publish official guidance which endorses particular electronic identification schemes or processes on a case by case basis, since this would greatly facilitate universal acceptance and undoubtedly increase usage of electronic identification. Without universal acceptance, electronic identification simply will not work for the syndicated loan product.

Chapter 4 – Customer due diligence – Question 47

It has been proposed that relevant persons should now be "required" to verify the law to which a body corporate is subject, its constitution and the full names of its board of directors "and senior persons" responsible for operations, rather than take "reasonable measures" to verify. We would like to emphasise that an absolute requirement could make the onboarding process practically difficult to satisfy and could lead to differences in approach and interpretation, particularly in the identification of "senior persons" who are not so easily verified in the same way as may be the case for directors. In addition, whilst we appreciate the importance of undertaking correct and consistent procedures to ensure maximum transparency, it should also be borne in mind that corporate requirements in different jurisdictions can vary depending on the way such entities are constituted and that sometimes a degree of flexibility needs to be maintained. In addition, arguably, there are already adequate protections in other parts of the MLD to ensure that obliged entities undertake all appropriate measures when carrying out their CDD procedures, without the need for a firm verification requirement. We would therefore suggest leaving this wording as currently drafted.

Chapter 5 – Obliged entities: beneficial ownership requirements – Questions 54/55

It has been proposed that relevant persons now be required to apply CDD when they have "any legal duty in a calendar year" to contact the customer for reviewing their relevant beneficial ownership information. We are concerned that this language is vague and 5.13 does not give any real clarification as to what kind of events would trigger a review. Given how conservatively some banks interpret these requirements, there is a chance that CDD refreshes could become unnecessarily cumbersome/frequent as a result (i.e. a technical legal duty to contact a customer about something relatively minor could be interpreted as "relevant" enough to require a full CDD refresh). We understand that this assessment is currently undertaken based on a frequency linked to the underlying risk profile of the customer in question and it would perhaps be more appropriate therefore if "relevant to the risk assessment for that customer for CDD purposes" in 5.13 was amended to "directly applicable to the risk assessment for that customer for CDD purposes". At the very least, it would be helpful if clarification could be given by Treasury as to the types of situation when a full CDD review is likely to be required.

Chapter 6 – Enhanced due diligence – Question 56

It has been proposed that the requirement to conduct enhanced due diligence ("**EDD**") be expanded from "natural persons or legal entities established in third countries" to "business relationships or transactions involving high-risk third countries". We believe that this has the potential to lead to very different interpretations being made by different banks and potentially result in the undertaking of EDD in a much wider range of scenarios, based on a simple legal assessment of the term, rather than a risk-based approach on when it is appropriate. We would therefore request that Treasury interpret this requirement quite narrowly and provide appropriate guidance on this point. "Involving" could, for example, capture borrowers who have minor business dealings with suppliers based in high risk third countries. Although due diligence is undertaken by lenders in respect of borrower supply chains and other such dealings it would not be appropriate for a mere technical involvement by a borrower/borrower group to a high risk third country for genuine commercial reasons to generate a requirement to undertake EDD on the underlying borrower itself.

Chapter 8 – mechanisms to report discrepancies in beneficial ownership information – Question 61

It has been proposed that when an obliged entity notices a discrepancy between the information it holds and that held on the PSC register, that it be required to report this, through a bespoke reporting mechanism, to a body such as Companies House. Whilst the Consultation has said that any notification should not "interfere unnecessarily" with the functions of obliged entities, we do not think that this should be a mandatory requirement, especially because the majority of discrepancies are likely to be minor administrative errors, rather than anything of substance. Ultimately it is the responsibility of the company whose details are registered to ensure that its beneficial ownership information is correct and up-to-date and obliged entities should not be required to police a system that they are ultimately not responsible for. In addition, arguably, there are already adequate protections in other parts of the MLD to ensure that obliged entities report any genuine concerns they have about their customers to the appropriate authorities.

We would be happy to discuss any aspect 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 Amelia.slocombe@lma.eu.com or by telephone on 0207 006 4114.

Yours faithfully

Amelia Slocombe
Managing Director
Loan Market Association

Annex I

Overview of the primary syndicated loan market and the syndicated loan product

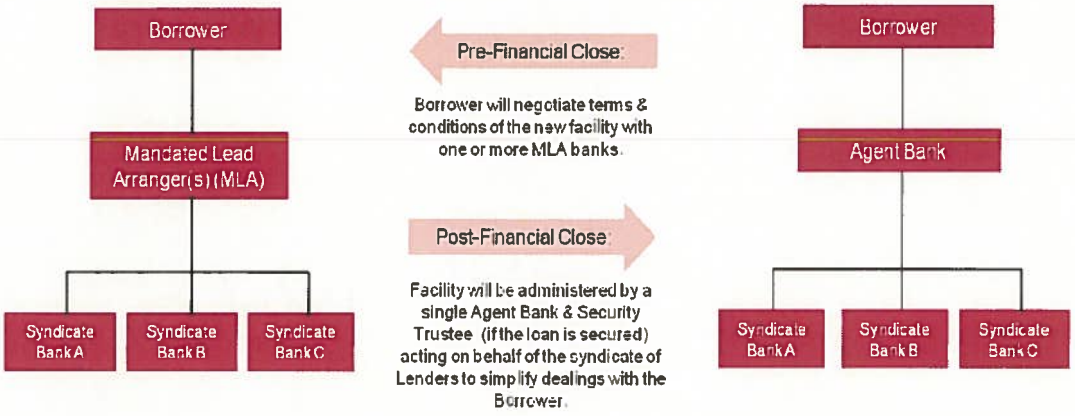
The syndicated loan market is an organised professional market, often international and cross-border in nature, providing much of the capital used by some of the largest companies in the world for a variety of purposes. The most common division of borrowers is between investment grade and sub-investment grade and the product is used for multiple types of financings, including acquisitions, projects, real estate, infrastructure, shipping, aircraft and structured trade and commodity finance.

A syndicated loan facility may encompass a single loan facility or a variety of different facilities, making up a total facility commitment (the "**Facility**"). Most commonly, this will constitute a term loan and/or a revolving credit facility, but may also include a swingline facility, standby facility, letter of credit facility, guarantee facility or other similar arrangements. Whilst the underlying instruments may differ, however, the structure of a syndicated loan is always the same - in each case, it involves two or more institutions contracting to provide credit to a particular corporate or group. Under a syndicated loan, the borrower or borrowing group (the "**Borrower**") will typically appoint one or more entities as "mandated lead arranger(s)" (the "**MLA**"). The MLAs will then proceed to sell down parts of the loan to other lenders (the "**Lenders**") in the primary market, whilst often retaining a proportion of the loan itself/themselves. The arrangement is put together under one set of terms and conditions (the "**Facility Documentation**"), usually following Loan Market Association ("**LMA**") recommended form facility documentation ("**LMA Facility Documentation**"), with each Lender's liability contractually 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 Lenders to participate in facilities of various amounts, well in excess of the credit appetite of a single Lender. The syndicates themselves can range in size. Syndicates of only two to three Lenders are often referred to as "club loans".

To facilitate the process of administering the loan on a daily basis, one Lender from the syndicate (usually an MLA) will be appointed as facility agent (the "**Agent**").

Although some syndicated loan facilities are unsecured (particularly when such loans are extended to highly rated investment grade borrowers), the majority of mid-market, M&A, real estate, asset finance, structured trade and project finance syndicated lending is, in some way, secured against some or all of the assets of the Borrower and/or other group members. If the syndicated loan is to be secured, a Lender from the syndicate (usually also the Agent) will be appointed to act as a security trustee (the "**Security Trustee**"), to hold the security on trust for the benefit of a defined class of beneficiaries (i.e. the Lenders and any other finance parties with a security interest, such as hedge counterparties (together known as the "**Secured Finance Parties**")).

The following diagram illustrates the structure of a syndicated loan, both pre and post financial close of a transaction:



The origination and syndication of a syndicated loan transaction takes place in the primary market. Following final allocation of commitments in respect of the Facility to the Lenders, the Facility then becomes "free to trade", subject to the terms and conditions contained in the Facility Documentation. The secondary loan market, therefore, refers to any sale of a loan by Lenders in the original syndicate ("**Seller**") or by a subsequent purchaser ("**Buyer**"). It should be noted that, whilst trading can take place as soon as the Facility becomes free to trade, such trades cannot be settled until the Seller becomes a Lender of record under the Facility Documentation.

A Lender may decide to sell its participation in a syndicated loan for a variety of reasons, including to realise capital, for risk management purposes, to meet regulatory capital requirements or to crystallise a loss. A Buyer, meanwhile, may wish to acquire/increase a commitment in a Facility, for example to develop/expand a Borrower relationship or simply for investment purposes.

Annex II

Article 31 of Directive (EU) 2015/849 as amended by Article 1 point 16) of Directive (EU) 2018/843

1. Member States shall ensure that this Article applies to trusts and other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts. Member States shall identify the characteristics to determine where legal arrangements have a structure or functions similar to trusts with regard to such legal arrangements governed under their law.

Each Member State shall require that trustees of any express trust administered in that Member State obtain and hold adequate, accurate and up-to-date information on beneficial ownership regarding the trust. That information shall include the identity of:

(a) the settlor(s);

(b) the trustee(s);

(c) the protector(s) (if any);

(d) the beneficiaries or class of beneficiaries;

(e) any other natural person exercising effective control of the trust.

Member States shall ensure that breaches of this Article are subject to effective, proportionate and dissuasive measures or sanctions.

2. Member States shall ensure that trustees or persons holding equivalent positions in similar legal arrangements as referred to in paragraph 1 of this Article, disclose their status and provide the information referred to in paragraph 1 of this Article to obliged entities in a timely manner, where, as a trustee or as person holding an equivalent position in a similar legal arrangement, they form a business relationship or carry out an occasional transaction above the thresholds set out in points (b), (c) and (d) of Article 11.

3. Member States shall require that the information referred to in paragraph 1 can be accessed in a timely manner by competent authorities and FIUs.

3a. Member States shall require that the beneficial ownership information of express trusts and similar legal arrangements as referred to in paragraph 1 shall be held in a central beneficial ownership register set up by the Member State where the trustee of the trust or person holding an equivalent position in a similar legal arrangement is established or resides.

Where the place of establishment or residence of the trustee of the trust or person holding an equivalent position in similar legal arrangement is outside the Union, the information referred to in paragraph 1 shall be held in a central register set up by the Member State where the

trustee of the trust or person holding an equivalent position in a similar legal arrangement enters into a business relationship or acquires real estate in the name of the trust or similar legal arrangement.

Where the trustees of a trust or persons holding equivalent positions in a similar legal arrangement are established or reside in different Member States, or where the trustee of the trust or person holding an equivalent position in a similar legal arrangement enters into multiple business relationships in the name of the trust or similar legal arrangement in different Member States, a certificate of proof of registration or an excerpt of the beneficial ownership information held in a register by one Member State may be considered as sufficient to consider the registration obligation fulfilled.

4. Member States shall ensure that the information on the beneficial ownership of a trust or a similar legal arrangement is accessible in all cases to:

(a) competent authorities and FIUs, without any restriction;

(b) obliged entities, within the framework of customer due diligence in accordance with Chapter II;

(c) any natural or legal person that can demonstrate a legitimate interest;

(d) any natural or legal person that files a written request in relation to a trust or similar legal arrangement which holds or owns a controlling interest in any corporate or other legal entity other than those referred to in Article 30(1), through direct or indirect ownership, including through bearer shareholdings, or through control via other means.

The information accessible to natural or legal persons referred to in points (c) and (d) of the first subparagraph shall consist of the name, the month and year of birth and the country of residence and nationality of the beneficial owner, as well as nature and extent of beneficial interest held.

Member States may, under conditions to be determined in national law, provide for access of additional information enabling the identification of the beneficial owner That additional information shall include at least the date of birth or contact details, in accordance with data protection rules. Member States may allow for wider access to the information held in the register in accordance with their national law.

Competent authorities granted access to the central register referred to in paragraph 3a shall be public authorities with designated responsibilities for combating money laundering or terrorist financing, as well as tax authorities, supervisors of obliged entities and authorities that have the function of investigating or prosecuting money laundering, associated predicate offences and terrorist financing, tracing, and seizing or freezing and confiscating criminal assets.

4a. Member States may choose to make the information held in their national registers referred to in paragraph 3a available on the condition of online registration and the payment

of a fee, which shall not exceed the administrative costs of making the information available, including costs of maintenance and developments of the register.

5. Member States shall require that the information held in the central register referred to in paragraph 3a is adequate, accurate and current, and shall put in place mechanisms to this effect. Such mechanisms shall include requiring obliged entities and, if appropriate and to the extent that this requirement does not interfere unnecessarily with their functions, competent authorities to report any discrepancies they find between the beneficial ownership information available in the central registers and the beneficial ownership information available to them. In the case of reported discrepancies Member States shall ensure that appropriate actions be taken to resolve the discrepancies in a timely manner and, if appropriate, a specific mention be included in the central register in the meantime.

6. Member States shall ensure that obliged entities do not rely exclusively on the central register referred to in paragraph 4 to fulfil their customer due diligence requirements as laid down in Chapter II. Those requirements shall be fulfilled by using a risk-based approach.

7. Member States shall ensure that competent authorities and FIUs are able to provide the information referred to in paragraphs 1 and 3 to the competent authorities and to the FIUs of other Member States in a timely manner and free of charge.

7a. In exceptional circumstances to be laid down in national law, where the access referred to in points (b), (c) and (d) of the first subparagraph of paragraph 4 would expose the beneficial owner to disproportionate risk, risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation, or where the beneficial owner is a minor or otherwise legally incapable, Member States may provide for an exemption from such access to all or part of the information on the beneficial ownership on a case-by-case basis. Member States shall ensure that these exemptions are granted upon a detailed evaluation of the exceptional nature of the circumstances. Rights to an administrative review of the exemption decision and to an effective judicial remedy shall be guaranteed. A Member State that has granted exemptions shall publish annual statistical data on the number of exemptions granted and reasons stated and report the data to the Commission.

Exemptions granted pursuant to the first subparagraph shall not apply to the credit institutions and financial institutions, and to obliged entities referred to in point (3)(b) of Article 2(1) that are public officials.

Where a Member State decides to establish an exemption in accordance with the first subparagraph, it shall not restrict access to information by competent authorities and FIUs.

8. [DELETED]

9. Member States shall ensure that the central registers referred to in paragraph 3a of this Article are interconnected via the European Central Platform established by Article 22(1) of Directive (EU) 2017/1132. The connection of the Member States' central registers to the platform shall be set up in accordance with the technical specifications and procedures

established by implementing acts adopted by the Commission in accordance with Article 24 of Directive (EU) 2017/1132 and with Article 31a of this Directive.

Member States shall ensure that the information referred to in paragraph 1 of this Article is available through the system of interconnection of registers established by Article 22(2) of Directive (EU) 2017/1132, in accordance with Member States' national laws implementing paragraphs 4 and 5 of this Article.

Member States shall take adequate measures to ensure that only the information referred to in paragraph 1 that is up to date and corresponds to the actual beneficial ownership is made available through their national registers and through the system of interconnection of registers, and the access to that information shall be in accordance with data protection rules.

The information referred to in paragraph 1 shall be available through the national registers and through the system of interconnection of registers for at least five years and no more than 10 years after the grounds for registering the beneficial ownership information as referred to in paragraph 3a have ceased to exist. Member States shall cooperate with the Commission in order to implement the different types of access in accordance with paragraphs 4 and 4a.

10. Member States shall notify to the Commission the categories, description of the characteristics, names and, where applicable, legal basis of the trusts and similar legal arrangements referred to in paragraph 1 by 10 July 2019. The Commission shall publish the consolidated list of such trusts and similar legal arrangements in the *Official Journal of the European Union* by 10 September 2019.

By 26 June 2020, the Commission shall submit a report to the European Parliament and to the Council assessing whether all trusts and similar legal arrangements as referred to in paragraph 1 governed under the law of Member States were duly identified and made subject to the obligations as set out in this Directive. Where appropriate, the Commission shall take the necessary steps to act upon the findings of that report.