LMA | Loan Market Association

FAQs

What is a syndicated loan?

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 LMA recommended form 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 a small number of Lenders are often referred to as "club loans".

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.

Why should the money laundering and terrorist financing risks associated with a syndicated loan in a primary context be seen as generally low risk?

For the following reasons:

- Syndicated loans are relationship-driven, committed facilities, (i.e. whilst the repayment profile may be amortised, the Facility remains outstanding (unless there is a Borrower default and it is subsequently accelerated) until its maturity date. As a result, in order to ensure that the Borrower is an attractive commercial investment, Lenders undertake extensive credit and legal analysis in respect of the Borrower, the guarantors, the wider group and any secured assets. This includes not only initial commercial and legal due diligence prior to first drawdown under the Facility, but ongoing monitoring throughout the life of the Facility until maturity. This means that the Lenders have an accurate and continuing understanding of the Borrower’s corporate activities, its overall performance and its financial condition.

- Syndicated loans are governed by a detailed set of terms and conditions, largely based on LMA Facility Documentation. LMA Facility Documentation contains numerous provisions that place certain obligations and restrictions on the Borrower, the guarantors and the group. The purpose of these provisions is to ensure that the Lenders are able to exercise an appropriate level of control, such control being commensurate with the Borrower's credit standing and the intended use of loan proceeds.

- Given that syndicated loans are advanced by a number of Lenders and each Lender is individually responsible for completing its own customer due diligence and ongoing monitoring, the likelihood of money laundering is arguably reduced, since any suspicious activity, however well concealed, is more likely to be picked up.

- Syndicated loans are designed for Borrowers whose borrowing requirements exceed the lending capacity of a single Lender. They are often multi-nationals, many of which will have their securities listed, or are parts of corporate groups whose securities are listed, on EU-regulated or comparable regulated markets. As a result, syndicated loans tend to be provided to Borrowers with existing borrowing track records, at least on a bilateral basis, and established business operations. Furthermore, they are rarely offered as a financing solution in isolation – rather one or more of the MLAs and certain Lenders may also provide other ancillary products and services such as cash management, foreign exchange, hedging and other forms of corporate finance, all of which, depending on the product, will require separate money laundering and terrorist financing risk assessments.

- Under a syndicated loan transaction, loan monies are transferred by the Lenders to the bank account of the Agent and are either transferred directly into the Borrower's account or, in some circumstances, to a third party bank account. Monies paid into third party accounts will always be connected with the specified purpose of the Facility (e.g. payable to a seller of an asset, or the seller's legal counsel, if loan proceeds are to be used towards an acquisition). Given that a syndicated loan results in the Borrower (directly or indirectly) receiving funds, the initial transaction is not likely to involve money laundering by the Borrower. Syndicated loan facilities, could, however, technically be used to integrate criminal proceeds which are then used to repay or prepay the loan. However, this risk is very low given that repayments/prepayments are received by the Agent into its bank account by way of electronic transfer. The Agent will then administer the repayment by passing on such sums directly to the bank account of the Lenders. Physical cash repayments of the Facility should not occur.

- Since the main risk of money laundering under a syndicated loan arises at the point of prepayment/repayment, Lenders should be mindful of any such payments that are made without good commercial rationale. That said, given the extensive and ongoing commercial and financial monitoring that all Lenders undertake throughout the life of the loan, and the fact that under LMA Facility Documentation the Borrower must provide a number of business days notice if it intends to make a prepayment, and is separately obliged to supply any information a Lender requires in connection with its financial condition and business operations, it should be possible for Lenders to investigate the source of any activity that might otherwise be regarded as suspicious.

Why should the money laundering and terrorist financing risks associated with a syndicated loan in a secondary context be seen as generally low risk?

- Whilst the secondary loan market is a traded market, it is not as heavily or as frequently traded as other capital market instruments. In addition, the majority of secondary market participants are regulated parties and regular participants of the market and also have long established relationships with their counterparts. This means that ad hoc transactions by unknown entities are rare and are likely to be picked up more readily than might be the case for heavily traded instruments.

- The time between trade and settlement is much longer than that of other wholesale products (particularly fixed income and equities), meaning that conversion of holdings to cash is not as quick. Furthermore, the universe of counterparties with whom secondary market participants can interact is much less diverse in a secondary loan market context than it is for other wholesale markets. This makes it less likely that money launderers would look to integrate criminal proceeds by way of loan investment, since success is often reliant on the ability to divest and reinvest rapidly and in an opaque manner.

- Loan settlement involves a certain amount of direct human intervention throughout the course of the transaction and, unlike other wholesale markets, is neither fully automated nor centrally cleared. This means that suspicious activity is more likely to be picked up in the time between trade and settlement date.

- Changes to Lenders are increasingly subject to Borrower consent provisions in the Facility Documentation, prohibiting existing Lenders from assigning or transferring interests in the Facility unless Borrower consent is first obtained. Alternatively, in many cases, an additional provision is included, providing that no such consent is required if the assignment or transfer is to an entity specified on an agreed list approved by the Borrower and the MLA prior to financial close. These types of control make it less likely that the types of entity involved in money laundering would have the ability to become Lenders under a Facility.

- Whilst the secondary loan market has the means to enable a "chain" of loan sales and purchases, involving different secondary market participants, the traded asset does not change in form, meaning that the audit trail between counterparties is transparent and identifiable.

- Secondary market participants are not individuals or retail investors. This means that the risks of money laundering associated with these types of entity are not a feature of the secondary loan market.

Why are Lenders/Buyers not customers of the MLA/Agent (or vice versa)?

Under the MLR, "relevant persons" are required to undertake customer due diligence and beneficial ownership checks on any "customer" with whom they have a "business relationship". However, whilst "business relationship" is defined under the MLR, the term "customer" is not. The lack of a clear definition has given rise to potentially unintended consequences, i.e. persons being treated as "customers" when perhaps this was not necessary or justified. Therefore, rather than treating all counterparties as "customers" and <u>then</u> considering whether the relevant person has a "business relationship" with that counterparty, an initial assessment should be undertaken to ascertain whether a genuine customer relationship (based on the facts and circumstances) exists. The term "business relationship" should then only be applied if it can be ascertained that the entity with whom the relevant person is dealing is actually a "customer".

The rationale for the fact that there is no customer relationship is as follows:

(A) Relationship between the Agent/Security Trustee and the Lenders

- No transaction/bank account is opened by the Agent/Security Trustee in the name of the Lenders.

- Under the terms of LMA Facility Documentation, the Agent/Security Trustee act on the instructions of either the "Majority Lenders" (usually those Lenders whose commitments aggregate more than 66 and ⅔ per cent of the total Facility commitment), a "Super Majority" of Lenders, or all Lenders. It does not act on the instructions of individual Lenders with regards to any decisions to be made in respect of the Borrower, the Facility or the secured assets (as applicable).

- The role of the Agent/Security Trustee is solely mechanical and administrative in nature. In addition, the Agent/Security Trustee is not able to exercise its own discretion except in very limited circumstances and English case law has determined that the Agent/Security Trustee has no implied rights beyond those contained in the Facility Documentation. It is also not generally liable for any error of judgment, nor is it expressly bound to supervise, or be in any way responsible for, any loss incurred by reason of its misconduct, omission or default. Again, this emphasises that the nature of the relationship between the Agent/Security Trustee and the Lenders is not that of a Customer, but rather a simple conduit created for administrative ease.

- Although the Agent/Security Trustee acts on behalf of the overall syndicate of Lenders, the services they undertake in respect of the Facility are paid for by the Borrower, in the form of an agency/security trustee fee.

(B) Relationship between the MLA and the Lenders

- The MLA does not provide any form of investment advisory service with regards to Lenders in the syndicate, nor, in the context of primary syndication, does it receive payment from the Lenders for its own account. Whilst the Lender will be made aware of the opportunity to join a syndicate by the

MLA/Bookrunner, its decision to do so will be based on its own independent analysis of the Borrower.

- The MLA is appointed by the Borrower. All arrangement and any ancillary fees payable to the MLA are paid by the Borrower, not the Lenders.

- Following primary syndication, the MLA has no ongoing obligations of any kind to any Lender under or in connection with the Facility Documentation. Although the MLA is a party to the Facility Documentation, its role ceases once the Facility Documentation has been signed and the Facility has been syndicated (unless it then becomes a Lender in its own right, in which case the parts of this guidance relevant to Lenders shall be applicable to the MLA in its capacity as Lender).

In addition, under equivalent US regulations (Section 326 of the USA Patriot Act (the "**Patriot Act**")) it is generally accepted that the Agent is not required to undertake KYC on the Lenders. This is on the basis that they merely serve as a "conduit" for information and funds between the Lenders and the Borrower(s). Given that the US syndicated loan market is a sophisticated one, and largely considered a comparable jurisdiction in regulatory terms, it would seem in the interests of market consistency to apply a similar money laundering assessment with regards to its treatment of syndicated loans. This would also enable the process to become more streamlined and allow resources to be focused on the greatest areas of risk.

Who are JMLSG?

(Taken from the JMLSG website)

The Joint Money Laundering Steering Group is made up of the leading UK Trade Associations in the Financial Services Industry.

Its aim is to promulgate good practice in countering money laundering and to give practical assistance in interpreting the UK Money Laundering Regulations. This is primarily achieved by the publication of industry Guidance.

JMLSG has been producing Money Laundering Guidance for the financial sector since 1990, initially in conjunction with the Bank of England, and latterly to provide regularly updated guidance on the various Money Laundering Regulations in force.

How should JMLSG Guidance be used?

(Taken from the JMLSG website)

The Guidance gives firms a degree of discretion in how they comply with AML/CTF legislation and regulation, and on the procedures that they put in place for this purpose.

It is not intended that the Guidance be applied unthinkingly, as a checklist of steps to take. Firms should encourage their staff to 'think risk' as they carry out their duties within the legal and regulatory framework governing AML/CTF.

The FCA has made clear its expectation that FCA-regulated firms address their management of risk in a thoughtful and considered way, and establish and maintain systems and procedures that are appropriate, and proportionate to the risks identified. The Guidance assists firms to do this.

When provisions of the statutory requirements and of FCA's regulatory requirements are directly described in the text of the Guidance, it uses the term must, indicating that these provisions are mandatory.

In other cases, the Guidance uses the term should to indicate ways in which the statutory and regulatory requirements may be satisfied, but allowing for alternative means of meeting the requirements. References to 'must' and 'should' in the text should therefore be construed accordingly.

What is the status of the Guidance?

(Taken from the JMLSG website)

POCA requires a court to take account of industry guidance that has been approved by a Treasury minister when considering whether a person within the regulated sector has committed the offence of failing to report where that person knows, suspects, or has reasonable grounds for knowing or suspecting, that another person is engaged in money laundering.

Similarly, the Terrorism Act requires a court to take account of such approved industry guidance when considering whether a person within the financial sector has failed to report under that Act.

The ML Regulations also provide that a court must take account of similar industry guidance in determining whether a person or institution within the regulated sector has complied with any of the requirements of the ML Regulations.

When considering whether to take disciplinary action against an FCA-regulated firm in respect of a breach of the relevant provisions of SYSC, the FCA will have regard to whether a firm has followed relevant provisions in this guidance.

When considering whether to bring a criminal prosecution in relation to a breach of the ML Regulations, the FCA may also have regard to whether the person concerned has followed this guidance. The guidance will therefore be significant for individuals being prosecuted, or subject to regulatory action, in relation to their responsibility for firms' systems and controls and/or in relation to their personal actions: for example, why did they fail to disclose?

The guidance provides a sound basis for firms to meet their legislative and regulatory obligations when tailored by firms to their particular business risk profile. Departures from good industry practice, and the rationale for so doing, should be documented, and may have to be justified, for example to the FCA.