

Solving for KYC

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Impact of MLR 2017 on KYC processes for syndicated lending

- NB: KYC processes are primarily governed by MLR 2017 for UK regulated entities
- Application of customer due diligence (CDD) measures (i.e. KYC) applies when a “relevant person” (i.e. a financial institution/credit institution for our purposes) establishes a “business relationship”
- Business relationships = *“means a business, professional or commercial relationship between a relevant person and a customer, which arises out of the business of the relevant person and which is expected by the relevant person, at the time when contact is established, to have an element of duration”*
- **No statutory definition of customer**
- Requirement to (1) identify customer and any beneficial owner (2) assess intended purpose/nature of the business relationship and (3) conduct ongoing monitoring
- Beneficial owner = 25% ownership (whether direct or indirect)
- Verification must take place before the establishment of the business relationship

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Outside MLR, key piece of guidance for UK regulated financial services firms is JMLSG
- Chapter 17, which relates to syndicated lending has been re-written by the LMA, following extensive consultation
- The ML and TF risks in syndicated lending are generally low because:
 - Extensive credit and legal analysis undertaken
 - Controls imposed via LMA Facility Documentation
 - Safety in numbers, since each MLA/Lender completes own CDD
 - Designed for sophisticated Borrowers
 - Rarely offered in isolation (ancillary facilities will have own CDD requirements)
 - Borrower repayments/prepayments are received by the Agent into its bank account by way of electronic transfer (i.e. no cash)

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Risk of money laundering is even further reduced in a secondary context from a Borrower/Guarantor perspective since CDD has already been undertaken
- Between lenders (i.e. lender KYC as opposed to borrower KYC) there is a low risk of ML/TF in secondary since:
 - Not a heavily traded market
 - Delay between trade and settlement (i.e. conversion of holdings to cash is not as quick)
 - Universe of trading counterparties is relatively small
 - Loan settlement involves some human interaction
 - Changes in lenders are often subject to borrower consent
 - Lenders are not retail investors or individuals

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Primary syndication - who is the "customer" for AML purposes?

Party	Who is the Customer?
MLA	Borrower
Agent	<p>This will be dependent on the relationship, but in a traditional syndicated loan arrangement, it is expected that the Borrower will be the Customer of the Agent</p> <p>(NB: reason for distinction is where you might have a split facility agent, paying agent role)</p>
Lender	Borrower

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Primary syndication - who is not a Customer for AML purposes?
 - None of the MLA, the Agent or the Security Trustee has a Customer relationship with each individual Lender in the syndicate. Similarly, none of the Agent, Security Trustee, MLA or Technical Bank is a Customer of the Lender
 - That said, risk profile of transaction should still be considered on a case by case basis

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Why are lenders not customers of the agent?
 - Go back to the factual definition of “customer”
 - No transaction account is opened by the agent/security trustee in the name of the lenders
 - Under a syndicated loan arrangement, the agent/security trustee acts on the instructions of either the "Majority Lenders", a "Super Majority" of lenders, or all lenders. It does not act on the instructions of individual Lenders
 - The role of the agent/security trustee is solely mechanical and administrative in nature (and it can be undertaken by an entity that is not a FI/CI – i.e. third party agents).
 - 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, and for the benefit of, the borrower

Conclusion: how can you have a customer who can't instruct you independently of others and who doesn't pay you for your services?

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Secondary - who is the "customer" for AML purposes?

Party	Who is the Customer?	Additional information
Seller/Grantor	Buyer/Participant	And vice versa
Buyer	Borrower, once Buyer becomes lender of record	Not required if Buyer acquires loan as a short term holding for trading purposes

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Secondary - who is not a Customer for AML purposes?
 - Although the Agent has a role to play with regard to effecting the transfer of loan commitments from a Seller to a Buyer, it will not have a “customer” relationship with any Buyer
 - In the context of a sub-participation, the customer relationship is between the Grantor and the Participant. There is no customer relationship between the Participant and the Borrower

MLR - reliance provisions

- MLR enables reliance on third parties to meet CDD requirements, but ultimate responsibility remains with the relevant person
- Requirement to be able to obtain all information needed from third party being relied upon
- Must enter into “arrangements” with third party to enable it to obtain identification and verification documentation on request, and require it to retain copies
- This does not require a formal contractual arrangement BUT, the requirement to obtain documentation is problematic and the third party must consent to reliance
- There has been some discussion as to whether agents could act as third parties for reliance purposes (especially for buyers in secondary who do not have direct access to KYC information) but agents are reluctant to take on this role
- Potential solution: simple transfer of KYC information from primary deal site to secondary deal site by agent

The LMA's work in relation to UK implementation and the JMLSG guidelines (cont'd)

- Next steps (cont'd):
 - Chapter 17 approved and published by JMLSG
 - LMA has had meetings with both FCA Financial Crime and HMT to explain the approach of the guidance and outline ongoing issues
 - HMT has responded with queries in respect of Chapter 17, but only in respect of Borrower KYC to be conducted by incoming buyers in secondary
 - HMT has published a consultation as a result of MLD 5
 - FCA Financial Crime acknowledged (albeit informally and not in writing):
 - that it would look to follow JMLSG guidance even prior to official sign off by HMT
 - that it is involved in the process whereby the guidance is signed off by a treasury minister (i.e. it signs off prior to HMT)

Commission's directive to amend MLD4 (MLD5)

- The Commission's directive to amend MLD4 (that is, MLD5) makes a number of amendments to MLD4
- Key changes from a syndicated loan perspective are:
 - More stringent requirements regarding access to beneficial ownership information (particular issues from a syndicated loan perspective for security trusts and security trustees)