

17: Syndicated Lending

Note: This sectoral guidance is incomplete on its own. It must be read in conjunction with the main guidance set out in Part I of the Guidance.

This sectoral guidance considers specific issues over and above the more general guidance set out in Part 1, Chapters 4, 5, and 7, which firms engaged in syndicated lending may want to take into account when considering applying a risk-based approach.

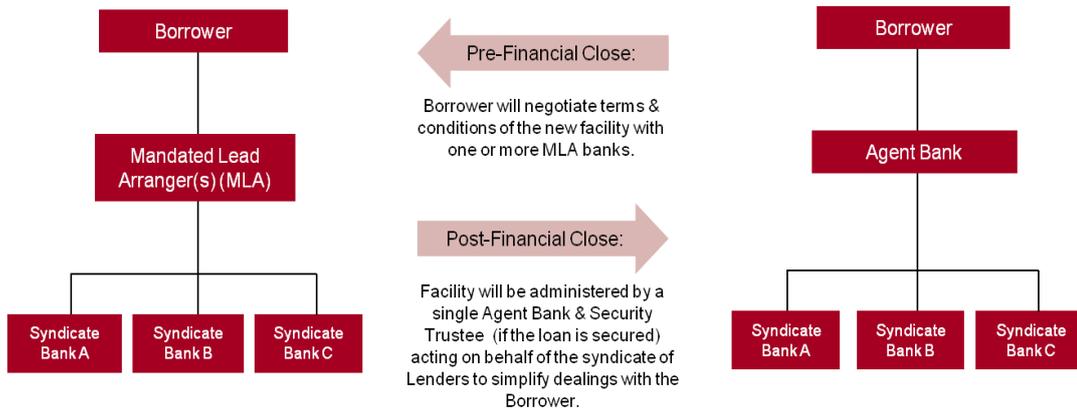
Overview of the market

- 17.1 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.

Overview of the product

- 17.2 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".
- 17.3 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**").
- 17.4 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 (the "**Group**"). 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**")).

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



17.6 Role of the parties

The following section describes the role of the various parties to a typical syndicated loan transaction:

- **Borrower.** A corporate, partnership or other legal entity which seeks to borrow funds and/or arrange credit facilities by way of a syndicated loan. Because of the nature of the financing, Borrowers are commonly corporate vehicles, but may also be financial institutions or sovereign states (this being more common in certain jurisdictions). From a credit perspective, Borrowers will range from large investment grade to mid market, unrated, entities. However, due to the typical size of the facilities and the number of Lenders involved, this type of borrowing tends not to be appropriate for individuals, small corporate borrowers or those at the lower end of the credit spectrum. In addition to those Borrowers under a syndicated loan facility who are “day 1” Borrowers (i.e. those Borrowers who are expected to draw on the Facility from the outset (“**Principal Borrowers**”)), the Facility may also be available to additional borrowers (“**Additional Borrowers**”). Additional Borrowers are almost always affiliates of the Principal Borrowers i.e. either direct or indirect holding companies or subsidiaries (“**Affiliates**”). Additional Borrowers may be party to the Facility Documentation at close of the transaction, but may be distinguished from Principal Borrowers, either because they do not intend to draw down until a future date, or they require some kind of standby facility (the expectation being that they will not draw down at all). Alternatively, Additional Borrowers may not be party to the Facility Documentation from the outset, but rather given the ability to accede in the future, subject to the satisfaction of certain conditions set out in the Facility Documentation.
- **Guarantor.** Certain entities may be or become parties to the Facility Documentation as guarantors (or enter into a standalone guarantee document) (“**Guarantors**”). Guarantors under a syndicated loan are usually Affiliates of the Borrower but for some transactions, third party guarantees (given by entities connected with the transaction) may also be provided in addition or instead. Whilst the types of guarantee entered into can vary, most commonly guarantors provide “all monies” guarantees by which the Guarantors guarantee the punctual performance of the Borrower’s (and any other Guarantor’s) obligations, undertake to pay any amount due but unpaid by the Borrower (and any other Guarantor) and agree to provide an indemnity, should the guarantee prove to be unenforceable.
- **Security providers.** Certain entities (including the Borrower) may provide security over assets to secure the obligations of the Borrower to the Lenders (usually via the entry into

a standalone security document) ("**Security Providers**"). Security Providers under a syndicated loan are usually Affiliates of the Borrower (and often also Guarantors), but for some transactions, third party security (given by entities connected in some way with the transaction) may also be provided in addition or instead.

- **MLA.** The MLA leads the commercial negotiations with the Borrower prior to accepting the mandate (i.e. the agreement to provide credit facilities). By the very nature of this appointment, it is likely that the MLA will have an existing (and possibly well-established) customer relationship with the Borrower, and may also become a Lender in respect of the Facility to be advanced. A syndicated loan transaction may have one or more MLAs. The MLA is normally responsible for working with the Borrower to agree the type of facilities it requires, negotiating the broad terms of those facilities and advising on roles, timetable and approach to the market. In some instances it will also "underwrite" the transaction, meaning that it will guarantee to provide the entire Facility commitment, and take on the risk of failing to syndicate the full Facility commitment to other Lenders. If the loan is not fully syndicated, the underwriting MLAs will be obliged to make up any shortfall (although they may later try to sell their commitment in the secondary loan market). If the transaction is not underwritten, the MLA will agree with the Borrower to try to syndicate on a "best efforts" basis, meaning that the MLA will commit to a certain amount of the Facility and undertake to do its best to find other Lenders to provide the remaining amount. In such a case, the Borrower bears the risk of the MLA failing to syndicate the full Facility. 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 becomes a Lender in respect of the Facility to be advanced.
- **Bookrunner.** The Bookrunner is an associated role to that of the MLA. Its designated function is to control the syndication process and the final make-up of the syndicate. The Bookrunner therefore manages the primary distribution process, whether that be to sell down the underwritten commitment of the MLAs, or syndicate the loan on a best efforts basis. The Bookrunner will usually be from the same institution as that of the MLA. As is the case for the MLA, although the Bookrunner is a party to the Facility Documentation, its role ceases once the Facility Documentation has been signed and the Facility has been syndicated.
- **Co-ordinator.** This role is generally relevant to club loans or small syndicates, where a small group of Lenders contract to provide funds to a Borrower without necessarily intending to syndicate the transaction to additional Lenders. A Co-ordinator is therefore appointed to facilitate the smooth execution of the transaction, liaising with Lenders' counsel and the Lenders themselves to ensure fluid communication and consensus on the Facility Documentation.
- **Lenders.** These are the syndicate Lenders which contract to lend the funds that have been arranged for the Borrower by the MLA. Although Lenders were traditionally banks, they now increasingly include other types of non-bank professional institutional investor, including funds, insurance companies and CLOs. The types of Lender investing in a syndicated loan will vary according to the nature and credit standing of the Borrower and the sector(s) and jurisdiction(s) in which it operates.
- **Agent.** Whilst the role of the Agent is varied, the tasks it performs are solely of an administrative and mechanical nature. The Agent has a number of discrete functions, including acting as a conduit for all payments and notices between the Borrower and Lenders, acting as the point of contact for the Borrower, and taking receipt of all compliance certificates and other information from the Borrower (and distributing it to the Lenders). Even though the agency function is often performed by an MLA or syndicate

Lender, occasionally it may be administered by an unaffiliated third party, whose corporate purpose is expressly set up to provide the agency function. Finally, the role of Agent may also be split, for example as follows:

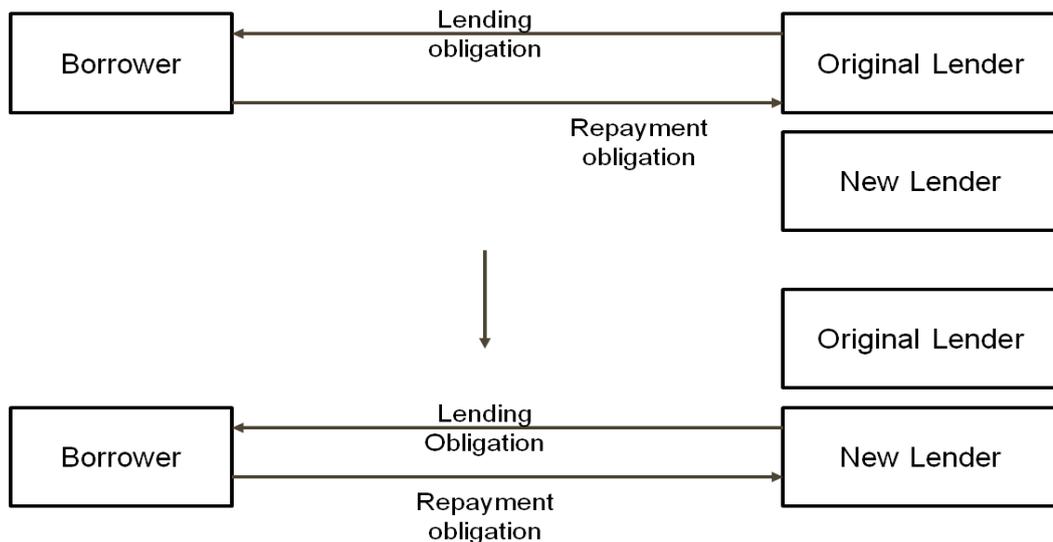
- between that of paying agent, with responsibility for disbursement of all payments relating to the Facility (the “**Paying Agent**”) and facility agent, with responsibility for information flows and other non-payment related matters (the “**Facility Agent**”). Such a division of roles is less common, but may be more likely when the Paying Agent is also the account bank for the Borrower (i.e. the institution at which the Borrower's bank accounts are held (“**Account Bank**”); and
 - where different types of facility (e.g. a senior facility and a mezzanine/junior facility) are to be provided by distinct groups of Lenders on different commercial terms (often provided to different Borrowers within the corporate group and subject to separate Facility Documentation) separate Agents may be appointed in respect of each facility (e.g. a senior Agent and a mezzanine/junior Agent). The relationship between the various finance parties will usually be governed by an intercreditor agreement.
- **Security Trustee.** Whilst the role of the Security Trustee is varied, the tasks it performs are solely of an administrative and mechanical nature. Only relevant to secured syndicated loan transactions, the role of the security trustee or security agent (“**Security Trustee**”) is designed 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 secured assets) and for making distributions to the Secured Finance Parties on any enforcement (i.e. if a Borrower defaults on its loan repayments, the loan is accelerated and the secured assets are sold to repay the loan); and (2) if 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 throughout the life of the loan, as new Lenders join and existing Lenders transfer part or all of their interest (see Paragraphs 17.7 to 17.9 for further details). In certain situations, the Security Trustee may also act as Account Bank for the Borrower, and exercise controls over any bank accounts of the Borrower secured in favour of the Secured Finance Parties. For administrative ease, the Security Trustee will often be from the same institution as that of the Agent. It may also be administered by an unaffiliated third party, whose corporate purpose is expressly set up to provide the security trustee function.
 - **Technical Banks.** Certain firms may take on other ancillary roles within the context of a syndicated loan transaction, for example, act as technical banks (such banks providing periodical technical reports to Lenders, supplied via the Agent, on certain matters to enable them to better monitor the Borrower's obligations in respect of the Facility (“**Technical Banks**”). The subject matter of the reports will depend on the nature of the business/assets financed (e.g. performance of oil wells under an oil transaction). Although the reports are addressed to the Lenders, the fees incurred for acting as a Technical Bank are recovered from the Borrower. For administrative ease, the Technical Bank will often be from the same institution as that of the Agent. Alternatively, the role undertaken by a Technical Bank, may also be undertaken by an unaffiliated third party technical advisor separate from the Agent institution.

Overview of the secondary loan market

- 17.7 As outlined above, 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

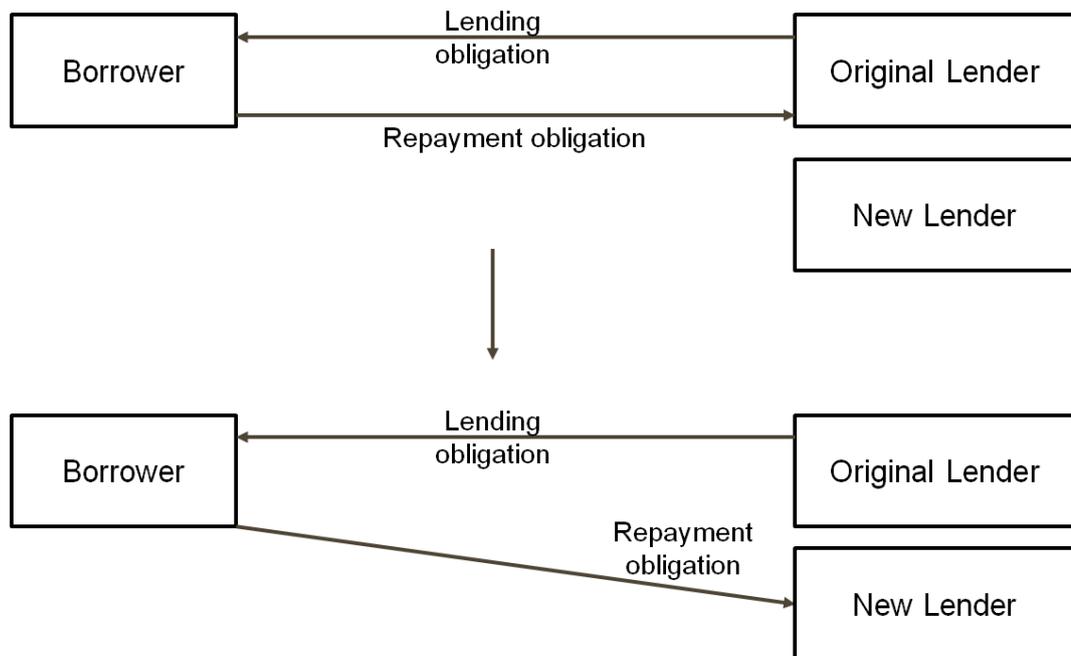
the Lenders, the Facility then becomes "free to trade", subject to the terms and conditions contained in the Facility Documentation. The secondary loan market, therefore, refers to any sale of a loan by Lenders in the original syndicate ("**Seller**") or by a subsequent purchaser ("**Buyer**"). It should 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.

- 17.8 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.
- 17.9 There are different types of transfer mechanic which may be used when transferring a commitment in a syndicated loan. The most common are:
- **Novation.** A novation enables a Seller to transfer all its rights and obligations under the Facility Documentation to a Buyer, and is the most common method of sale and purchase of loans under English law. The following diagram illustrates this process:



A novation therefore results in the cancellation of the rights and obligations of the Seller under the Facility Documentation, and the assumption of equivalent rights and obligations by the Buyer in relation to all parties to the Facility Documentation. Accordingly, the Seller ceases to be a party to the Facility Documentation and the Buyer becomes the Lender under the Facility Documentation. Whilst the agreement of the Borrower and all other parties to the Facility Documentation is required for the novation to be effective, LMA Facility Documentation contains novation provisions, whereby all parties provide the requisite consent when they become a party to the Facility Documentation, provided any procedures and conditions specified therein are complied with. The nature of these conditions will vary from transaction to transaction, but it is common for the Borrower to have the right to consent to, or be consulted with in relation to, the identity of the Buyer. A novation will usually be achieved through the signing of a "transfer certificate" by the Seller, Buyer and Agent in the form attached as a schedule to the Facility Documentation ("**Transfer Certificate**").

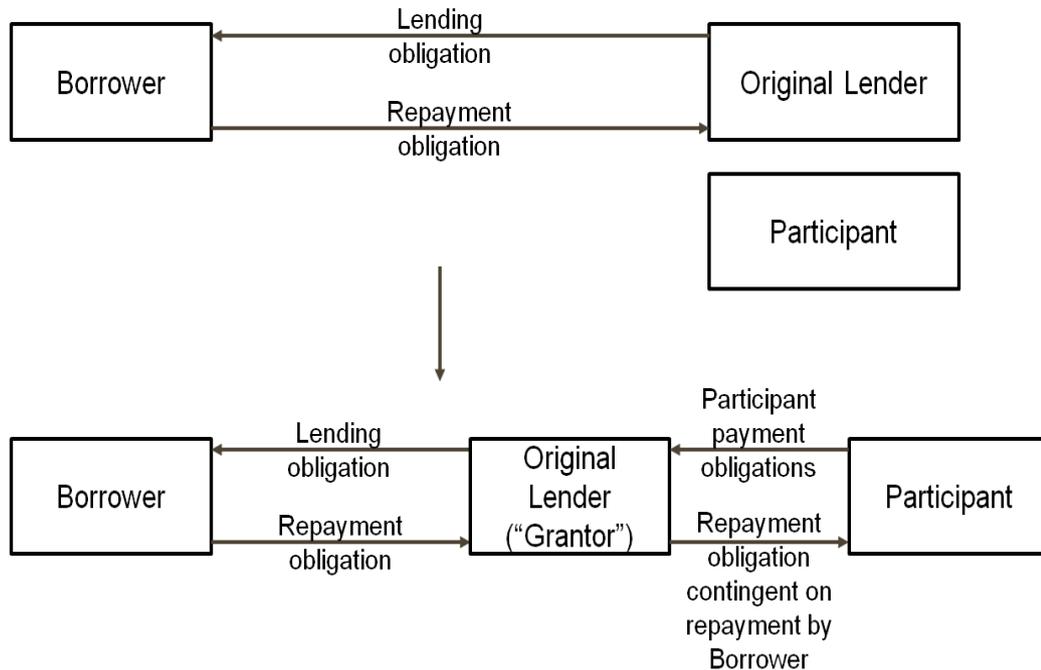
- Assignment.** An assignment enables a Seller to transfer its rights, but not its obligations under the Facility Documentation to a Buyer. The obligation of the Seller to advance any additional monies required under the terms of the Facility Documentation therefore remains, as well as its other obligations to the Lenders and other finance parties. If, at the same time as assigning its rights under the Facility Documentation to a Buyer, the Seller also wants to dispose of its corresponding obligations, the agreement of all parties to the Facility Documentation is required. The following diagram illustrates the assignment of rights:



An act of assignment therefore results in the transfer of the rights of the Seller under the Facility Documentation to the Buyer. In the context of the sale of a loan by way of assignment, it is common for the Seller to dispose of its corresponding obligations to the Buyer at the same time. Whilst the agreement of the Borrower and all other parties to the Facility Documentation is required for a disposal of obligations by a Seller and a corresponding assumption of those obligations by a Buyer to be effective, LMA Facility Documentation contains assignment provisions, whereby all parties provide the requisite consent, provided any procedures and conditions specified in the Facility Documentation are complied with. The nature of these conditions will vary from transaction to transaction, but it is common for the Borrower to have the right to consent to, or be consulted with in relation to, the identity of the Buyer. An assignment of rights and disposal/assumption of obligations will usually be achieved through the signing of an "assignment agreement" by the Seller, Buyer and Agent in the form attached as a schedule to the Facility Documentation ("**Assignment Agreement**"). Once an Assignment Agreement is effective, the Seller's rights under the Facility Documentation are assigned to the Buyer, the Seller's obligations under the Facility Documentation are released and the Buyer becomes a party to the Facility Documentation as Lender and bound by equivalent obligations to those of the Seller. An assignment is usually used as an alternative to novation.

- Sub-participation.** A sub-participation is a separate contractual arrangement between a Seller (known in this context as a "**Grantor**") and a Buyer (known in this context as a "**Participant**"), whereby the Participant acquires an indirect economic interest in the loan from the Grantor and assumes the risk of the commitment. There is, however, no legal

transfer of the loan interest itself (i.e. the Grantor remains the Lender). The following diagram illustrates the process:



A sub-participation can include either a "funded participation", or a "risk participation". Where a commitment is participated on a funded basis, the Participant will fund the Grantor of the participation for the drawn amount of the commitment. When, during the life of the participation, any sum falls due from the Grantor under the Facility Documentation which is attributable in whole or in part to the asset which is the subject of the funded participation, the Participant is required to put the Grantor in funds so that the Grantor can meet its obligations in this regard. On receipt of principal, interest or commitment commission, the Grantor will pass on to the Participant the appropriate amount. By contrast, under a risk participation, the Participant does not put the Grantor in funds to enable it to make advances under the Facility Documentation at the time that they are made. Instead, the Participant is only called upon to make a payment to the Grantor if the Borrower does not make a relevant payment due under the Facility Documentation (whether it be a payment of interest or fees, or a repayment of principal). A risk participation is therefore more akin to a guarantee.

The treatment of parties within the secondary loan market, and the issues to be considered from a money laundering perspective are set out in paragraphs 17.19 to 17.26.

What are the money laundering and terrorist financing risks in syndicated lending?

17.10 By their very nature, the money laundering and terrorist financing risks associated with a syndicated loan are generally low 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 (three to seven years being the average tenor)). As a result, in order to ensure that the Borrower is an attractive commercial investment (and that any Guarantors/Security Providers/secured assets are adequate), 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.
- Under LMA Facility Documentation, Lenders confirm that they are, and will continue to be, solely responsible for making their own independent appraisal and investigation of all risks arising under or in connection with the transaction. This includes matters relating to the financial condition, status and nature of the Borrower and the Group, the legality of the transaction documentation and the accuracy and completeness of any information they provide. Given that syndicated loans are advanced by a number of Lenders and each Lender is individually responsible for completing its own CDD and ongoing monitoring (subject to the any reliance being placed on third parties under Regulation 39), 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 sophisticated 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. Finally, 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.

17.11 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. Whilst large unexpected prepayments might be a cause for concern, these may be explained by the nature of the Borrower's business, or a recent asset disposal. When these situations occur, they should nevertheless be considered carefully and further thought should be given to the source of the funds used to effect the prepayment or repayment. Consideration should also be given as to whether the Borrower was an existing customer of the Lender prior to the Facility being advanced, or was a new customer with whom the Lender did not have a customer relationship prior to advancing the Facility.

- 17.12 When syndicated loans are guaranteed, such guarantee may be given by a Guarantor situated in a different jurisdiction from the Borrower. Such arrangements may serve a legitimate business purpose, making possible certain transactions which may otherwise not be achievable due to the Borrower's standalone credit risk. However, they may also make it easier to conceal the source of illicit funds, particularly when the guarantee is given by a Guarantor who is not an Affiliate of the Borrower. Particular care should therefore be taken when Lenders are seeking to rely upon the guarantee of an unaffiliated third party Guarantor, especially when such Guarantor is resident in a different jurisdiction from the Borrower. In any event, the risk of money laundering will only arise at the point at which the Lenders seek to enforce the guarantee.
- 17.13 When syndicated loans are secured, security may be given over assets held in a different jurisdiction from the Borrower. Such arrangements may serve a legitimate business function and enable certain types of transaction to take place which may otherwise not be achievable due to the Borrower's standalone credit risk. However, this may make it easier to conceal the source of illicit funds, particularly when the security is given by a third party who is not an Affiliate of the Borrower. Particular care should therefore be taken when Lenders are seeking to rely upon unaffiliated third party security, especially when the Security Provider is resident in a different jurisdiction from the Borrower. That said, given that, by its very nature, security will not be enforced until the Borrower has defaulted under the loan, the risk of money laundering will only arise at the point at which the Lenders seek to enforce the security.

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

- 17.14 The obligation on each party to a syndicated lending arrangement to verify the identity of the customer (the "**Customer**") is as follows:

(A) MLA/Co-ordinator

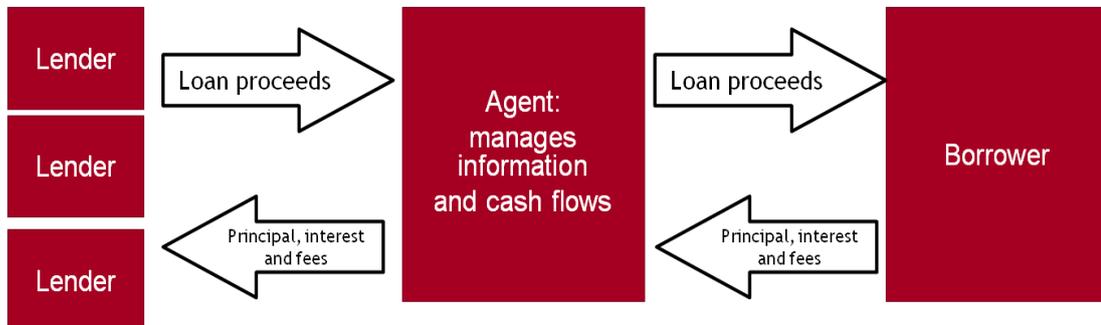
The Borrower is the Customer of each MLA/Co-ordinator (with both roles being from now on referred to solely as "MLA"). Although the MLA manages the process in respect of the underlying Lenders, the Borrower is the party for whom it is arranging the Facility.

In those circumstances in which there is a clear division of roles between the MLA and the Bookrunner (as outlined above), the Customer relationship will be between the Borrower and the MLA and not between the Borrower and the Bookrunner. Unless the roles of MLA and Bookrunner are combined, the Bookrunner will have no Customer relationship with the Borrower.

In those circumstances in which the MLA does not become a Lender after primary syndication of the Facility (i.e. the Bookrunner syndicates the entirety of the MLA's commitment), the Customer relationship between the MLA and the Borrower will cease at the point of final allocation and the MLA will have no ongoing obligation to monitor the Borrower in respect of the Facility from that point onwards.

(B) Lenders

The Borrower is the Customer of each Lender. Whilst the Agent manages the overall fund flow (as illustrated by the diagram below), it is the Lender which receives the funds from the Borrower in the form of interest and principal repayments, monitors the corporate activities and financial condition of the Borrower and controls any decision making process in respect of the Facility.



A risk-based approach should be taken when assessing the timing and nature of the required CDD in respect of Additional Borrowers, Guarantors, or Security Providers. This is on the basis that the risk of money laundering will not arise until a future point in time, if at all (i.e. only if the Additional Borrower draws down/accedes to the Facility or if the Lenders seek to enforce the guarantee/security against the relevant Guarantor/Security Provider). Particular care should however be taken in certain situations e.g. when the Additional Borrower/Guarantor/Security Provider is not an Affiliate of the Borrower, is located in a high-risk third country or is otherwise considered higher risk.

In respect of those situations when a particular party to a syndicated loan transaction may not become a Customer until a future point in time (a “**Potential Customer**”), the Lender may adopt a risk-based approach and, until the Potential Customer becomes a Customer, only carry out checks which it considers proportionate to the risk profile of the Potential Customer. This may include, for example, regard being had to the legal form of the Potential Customer, its jurisdiction and its connection to the transaction, as well as checking for adverse information and PEPs and sanctions-related screening. Depending on their nature, any material adverse indicators may prompt the decision to undertake additional measures in certain circumstances. In any event, at the point at which the Potential Customer becomes a Customer, CDD should be undertaken if this has not already been done.

(C) **The Agent/Security Trustee**

The relationship between the Borrower and the Agent/Security Trustee will not always mean that the Borrower is a Customer of the Agent/Security Trustee.

An important factor to be taken into consideration includes the precise nature of the Agent’s/Security Trustee’s role in respect of the Facility (e.g. whether it is also acting in an additional capacity to that of Agent/Security Trustee, by virtue of which a Customer relationship exists – such as where the Agent/Security Trustee is also acting as Account Bank of the Borrower, or also as an MLA or Lender.

Where there is more than one Agent/Security Trustee in respect of the Facility (e.g. a senior Agent and a junior Agent and/or a senior Security Trustee and a junior Security Trustee), each Agent/Security Trustee is responsible for determining the nature of its relationship with the Borrower, and whether this constitutes a Customer relationship.

In respect of those situations when a Borrower is not a Customer of the Agent/Security Trustee, the Agent/Security Trustee should assess the more general risks of money laundering under Regulation 18 and carry out checks which it considers proportionate to the risk profile of the Borrower. This may include, for example, regard being had to the legal form of the Borrower, its jurisdiction and the nature/purpose of the transaction, as well as checking for adverse information and PEPs and sanctions-related screening. The Agent should also consider the source of Borrower repayments/prepayments. Depending on their nature, any material adverse indicators may prompt the decision to undertake additional measures in certain circumstances.

Primary syndication - who is not a Customer for AML purposes?

- 17.15 Although a syndicated loan is a tri-partite arrangement from a structural perspective, none of the MLA, the Agent, the Security Trustee or any Technical Bank 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.
- 17.16 Notwithstanding the fact that the Lender is not a Customer of the MLA, the Agent, the Security Trustee or the Technical Bank (or vice versa), all parties will, as part of their general financial crime risk assessment, take account of the risk profile of the transaction and of each party involved. This may include ascertaining a party's legal form (taking into account each party's jurisdiction and whether or not it is regulated within the EEA or an assessed low risk jurisdiction), checking for adverse information and PEPs and sanctions-related screening.

Primary syndication - customer due diligence

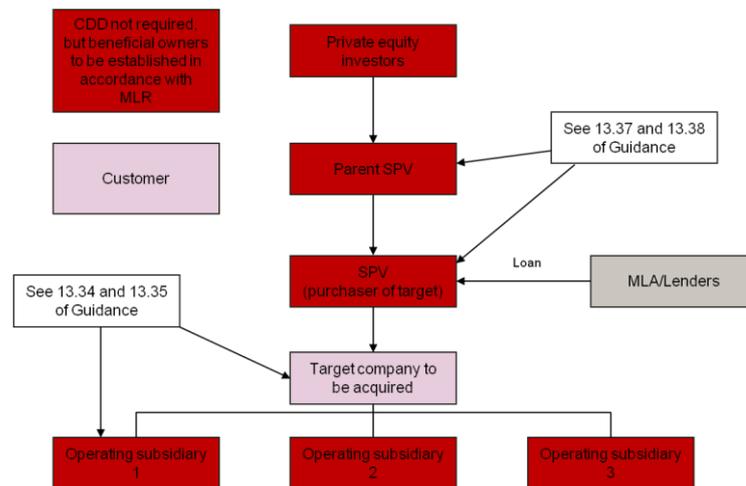
- 17.17 Each firm should apply the guidance set out in Part I, Chapter 5 of the Guidance, in line with its risk-based approach, as follows:

Party	Who is the Customer?	Additional information
MLA	Borrower	Where there is more than one MLA, the guidance on multipartite relationships in Part I, Chapter 5, Sub-Paragraph 5.6.2 of the Guidance is applicable.
Agent	This will be dependent on the relationship with the Agent as discussed in paragraph 17.14 (C)	Where relevant, the Agent may, subject to appropriate arrangements being in place, rely on the CDD carried out by the MLA on the Borrower.
Lender	Borrower	Where there is more than one Lender, the guidance on multipartite relationships in Part I, Chapter 5, Sub-Paragraph 5.6.2 of the Guidance is applicable. The Lender may, subject to appropriate arrangements being in place, rely on the CDD carried out by the MLA on the Borrower.

Firms should have regard to the additional guidance in paragraphs 17.29 and 17.31 in those instances where the Customer is either a fund or the branch/subsidiary/affiliate of a financial or credit institution.

Establishing the Customer when lending to corporate groups

- 17.18 For certain types of syndicated loan, e.g. those required to fund an acquisition, a particular project or to effect a restructuring, it is common for new special purpose vehicles (“SPVs”) to be incorporated solely for the purpose of the transaction. In such circumstances, only entity/ies within the anticipated corporate structure which is/are the Customer, will be subject to CDD requirements. This may vary from transaction to transaction. CDD will not necessarily be required in respect of every SPV incorporated in anticipation of a transaction. This is because the risk of money laundering occurs at the level of the operating subsidiaries, not with the newly incorporated SPV. Where the syndicated loan relates to a leveraged acquisition, firms may find it helpful to refer to Chapter 13 of the Guidance, and in particular the Guidance related to “Newcos” (13.33, 13.37 and 13.38). An example of an acquisition structure and the CDD requirements are set out here:



What are the money laundering risks from a secondary market perspective?

- 17.19 When looking at the risk of money laundering and terrorist financing in relation to the Borrower/Guarantor during a secondary loan market transaction, given that CDD will have already been undertaken by the MLA and the Lenders during the course of primary syndication, the risk of money laundering is even further reduced in a secondary context from a Borrower/Guarantor perspective.
- 17.20 The main risk of money laundering in relation to the Buyer/Seller/Grantor/Participant during a secondary loan market transaction (each a "**Secondary Market Participant**") will arise at the point of transfer between the relevant parties, when criminal proceeds could be used as a source of funds. Secondary Market Participants should therefore be mindful of the source of any such payments, particularly if they are dealing with a new counterparty with whom no prior relationship exists (and for this purpose an existing relationship with the parent entity of the counterparty would constitute an existing relationship with the new counterparty – see paragraphs 17.29 and 17.31 for further guidance).
- 17.21 Notwithstanding paragraph 17.20, the risk of money laundering in relation to a Secondary Market Participant is generally low for the following reasons:
- 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.

Secondary loan market - who is the "Customer" for AML purposes?

17.22 The obligation on each party to a secondary market transaction to verify the identity of the Customer is as follows:

(A) The Seller

The Buyer is the Customer of the Seller.

Upon the signing either of a Transfer Certificate (if the sale takes place by way of novation) or Assignment Agreement (if the sale takes place by way of assignment), the Borrower will cease to be the Customer of the Seller. That said, if the sale takes place by way of assignment and the Seller does not dispose of its corresponding obligations to the Buyer (i.e. it is an assignment of rights only) then the Borrower will remain a Customer of the Seller for so long as it has any obligation to advance additional monies required under the terms of the Facility Documentation.

(B) The Buyer

The Seller is the Customer of the Buyer. The Borrower will also become the Customer of the Buyer at the point when the Buyer becomes a Lender of record, unless the loan to be acquired by the Buyer equates to a short-term holding for trading purposes and the Buyer intends to dispose of the loan within a reasonably short time frame.

In addition, the Buyer may, subject to appropriate arrangements being in place, rely on the CDD carried out by the Seller on the Borrower. The circumstances in which it is appropriate for a Buyer to rely on the CDD carried out by the Seller include (but are not limited to):

- when the Borrower is determined to present a low degree of risk from a money laundering and terrorist financing perspective such that SDD measures may be applied;
- where the Buyer is not required to advance new monies to the Borrower in respect of the Facility; and/or
- where there has been no substantial lapse of time between the date when the Seller undertook CDD on the Borrower and the date of the trade.

(C) The Grantor in a Sub-Participation

The Participant is the Customer of the Grantor.

(D) The Participant in a Sub-Participation

The Grantor is the Customer of the Participant.

Secondary loan market - who is not a Customer for AML purposes?

17.23 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 for the reasons already outlined above in the context of its relationship with Lenders in a primary syndication.

17.24 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.

17.25 In those instances where a firm is acting as intermediary on behalf of the Seller, Buyer, Grantor or Participant (an “**Intermediary**”), the Customer of the Intermediary will be the party for whom the Intermediary is acting. There will be no Customer relationship between the Intermediary and any other counterparty to the transaction. The presence of an Intermediary in a secondary loan transaction does not remove the need for Seller/Grantor and Buyer/Participant to undertake CDD in respect of each other.

This process is summarised by the following table:

Party	Who is the Customer?	CDD to be undertaken by
Intermediary of Seller/Grantor	Seller/Grantor	Intermediary on Seller/Grantor
Intermediary of Buyer/Participant	Buyer/Participant	Intermediary on Buyer/Participant
Seller/Grantor	Buyer/Participant	Seller/Grantor on Buyer/Participant
Buyer/Participant	Seller/Grantor	Buyer/Participant on Seller/Grantor

Secondary loan market - customer due diligence

- 17.26 Each Secondary Loan Market Participant should apply the guidance set out in Part I, Chapter 5, in line with its risk-based approach, as follows:

Party	Who is the Customer?	Additional information
Seller	Buyer	
Buyer	Seller Borrower and Guarantor, subject to the guidance in paragraph 17.22(B)	If the Borrower and Guarantor are Customers of the Buyer, the guidance set out in relation to Additional Borrowers, Guarantors, Security Providers and Potential Customers in the primary market (in particular paragraphs 17.12, 17.13 and 17.14(C)) also applies.
Grantor	Participant	
Participant	Grantor	

Firms should have regard to the additional guidance in paragraphs 17.29 and 17.31 in those instances where the Customer is either a fund or the branch/subsidiary/affiliate of a financial or credit institution.

Monitoring

- 17.27 The money laundering and terrorist financing risks for firms participating in syndicated lending can be mitigated by the implementation of appropriate, documented monitoring procedures, as set out further in Part I, Chapter 5, Paragraph 5.7. Monitoring procedures of Borrowers are often relationship based, rather than transaction based, due to the nature of the product.
- 17.28 When incremental or additional facilities are envisaged under a Facility, firms should consider whether their ongoing monitoring of the Borrower is sufficient and whether it is necessary to update the CDD information held on the Borrower, for example where the identity documentation held is not adequate in the context of the assessed risk or where there are doubts about the veracity of the information already held.

Other guidance

Transacting with funds

- 17.29 Any transaction that a firm undertakes in the context of a syndicated loan whereby the Customer is a fund or CLO, may find it useful to consider the guidance in paragraphs 13.55 to 13.68 of this Part. Whilst Chapter 13 is specifically directed at private equity firms and private equity transactions, some of the provisions may be usefully applied in the context of a fund or CLO as a Secondary Market Participant under a syndicated loan. In particular, firms are directed to the guidance which states that, whilst firms must conduct CDD on the fund itself as the Customer, as set out in Part I, Chapter 5 according to the form of the fund vehicle, this may be achieved, subject to the firm's risk-based approach and the considerations outlined in paragraphs 13.61 to 13.68, by way of reliance on representations from its fund manager. Whether CDD is performed on the underlying fund or CLO will depend on the firm's relationship with both entities and the nature and status of the fund manager.

Furthermore, and subject to the above, when a firm transacts with a counterparty which is a sub-fund or CLO of a parent/umbrella fund, if the parent/umbrella fund is also a Customer, a

firm may, on a risk-based approach, take this into account when considering the extent of due diligence required in respect of the underlying sub-fund/CLO Customer, notwithstanding the fact that the sub-fund/CLO may be a separately incorporated trading vehicle, as opposed to a separate class of shares or legally ring-fenced portfolio. However, when the sub-fund/CLO Customer is located in a high-risk jurisdiction, firms must conduct enhanced due diligence on the Customer regardless of its relationship with the parent/umbrella fund.

Correspondent Relationships

- 17.30 A correspondent relationship is only created under Regulation 34(4)(a)(ii) "between and among credit institutions/financial institutions" in the event that the respondent is a Customer of the correspondent. Consequently, the relationship between a MLA/Agent/Security Trustee/Technical Bank and the Lenders (or vice versa) is not a "correspondent relationship" as defined in the Regulation, for the reasons previously outlined.

Whilst Agents do administer fund transfers, this is achieved via receipt of a payment into the Agent's account, and direct repayment out of that account. This is not the same as establishing a transaction account in the name of a credit institution/financial institution with the Agent, pursuant to which the Agent transfers funds out of that account on the credit institution/financial institution's instruction.

Further guidance on correspondent relationships is provided in Sector 16: *Correspondent relationships*.

Transacting with credit institutions/financial institutions

- 17.31 When credit institutions/financial institutions are Customers, if the Customer is a branch, wholly owned subsidiary or affiliate of another credit institution/financial institution, a firm may, on a risk-based approach, take into account the CDD undertaken in respect of the parent entity when considering the extent of due diligence required in respect of the underlying Customer. When the Customer is located in a high-risk jurisdiction, firms must conduct enhanced due diligence on the Customer regardless of its relationship with the parent.

Security Trustee obligations in the context of security trusts

- 17.33 Security Trustees under a syndicated loan are only required to maintain (and, if necessary, provide on request) a "description of the class of persons who are beneficiaries or potential beneficiaries under the trust" to meet their obligations under Regulation 44. In the context of a syndicated loan, this will equate to the "Secured Finance Parties, from time to time".