

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 sector

17.1 The syndicated loan market is an organised professional market, international in nature, providing much of the capital used by some of the largest companies in the world for a variety of purposes, ranging from working capital to acquisition financing. Banks and other financial institutions agree to make term loans and revolving credit loans to companies and may syndicate (offer on), or sell off, parts of their commitments to other banks, financial institutions or other entities. (In the case of structured trade finance transactions which may operate on a bilateral or syndicated basis, reference to Part II, Sector 15: *Trade Finance* should be made).

17.2 The following sets out the relationships that exist in loan syndications:

- **Borrower.** A corporate or other legal entity who seeks to borrow funds and/or arrange credit facilities through the international capital markets.
- **Mandated Lead Manager/Arranger/Bookrunner.** A mandated Lead Manager/Arranger/Bookrunner enters into an agreement to provide credit facilities to a borrower. By the very nature of this appointment, it is likely that the mandated Lead Manager/Arranger/Bookrunner will be a lender with which the Borrower already has an established relationship. A syndicated loan transaction typically may have one to four mandated Lead Managers/Arrangers/Bookrunners and many lenders. The Mandated Lead Manager/Arranger/Bookrunner normally is responsible for advising the Borrower as to 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.
- **Lenders.** The financial institutions that provide the funds that have been arranged for the Borrower by the Mandated Lead Manager/Arranger/Bookrunner.
- **Agent.** To facilitate the process of administering the loan an Agent is appointed. The Agent acts as the agent of the Lenders not of the Borrower, although it is the Borrower that pays the Agent's fees and charges. The Agent acts as an intermediary between the Borrower and the Lenders, undertaking administrative functions, such as preparing documentation, servicing and acting as a channel for information between the Lenders and Borrower. One of the Lenders from the syndicate is normally appointed as the Agent. The Agent has a number of important functions:
 - Point of contact (maintaining contact with the Borrower and representing the views of the syndicate);
 - Monitor (monitoring the compliance of the Borrower with certain terms of the facility);
 - Postman and record-keeper (it is the Agent to whom the Borrower is usually required to give notices); and
 - Paying agent (the Borrower makes all payments of interest and repayments of principal and any other payments under the loan agreement to the Agent. The

Agent passes these monies back to the Lenders to whom they are due. Similarly, the Lenders advance funds to the Borrower through the Agent).

- **Guarantor.** As part of the loan agreement, the Borrower may provide guarantors, who will guarantee repayment of the loan if the Borrower defaults on the loan, on a joint and several basis.

- 17.3 The cash flows arising from these arrangements are between the syndicate participants (lenders) and the Agent, and then on to the Borrower. Similarly, payments made by the Borrower to the Lenders take place via the Agent. The Lenders do not usually have any direct contact with the Borrower in respect of cash flows.
- 17.4 A secondary market also exists where banks and others buy and sell interests in these loans. The treatment of parties within the secondary market is set out in paragraphs 17.16 – 17.23.

What are the money laundering risks in syndicated lending?

- 17.5 Syndicated loans tend to be made to large, often multi-national companies, 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 such, the money laundering risk relating to syndicated loans for this type of customer should be regarded as low.
- 17.6 The features of all lending are generally that the initial monies advanced are paid into a bank account. In syndicated lending the monies are usually handled by the Agent making it unlikely that the transaction would be used by money launderers in the placement stage of money laundering. Syndicated facilities could, however, be used to layer and integrate criminal proceeds. Repayments are usually made from the Borrower's bank account to the Agent who administers the repayment from its bank accounts to the Lenders. Repayments in cash are unlikely.
- 17.7 Given that a syndicated loan results in the Borrower receiving funds from the Lender, the initial transaction is not very susceptible of money laundering. The main money laundering risk arises through variations in the loan arrangements such as the acceleration of an agreed repayment schedule, either by means of lump sum repayments, or early termination without good commercial rationale. When these circumstances occur they should be considered carefully and consideration must be given to the source of the money used to accelerate the repayment schedule, or terminate the loan early.

Primary market for syndicated loans

Who is the customer for AML purposes?

- 17.8 The obligation on each party to a syndicated lending arrangement to verify the identity of the customer is as follows:
- **Mandated Lead Manager/Arranger/Bookrunner:** The Borrower is the mandated Lead Manager/Arranger/Bookrunner's customer, as is the Agent.
 - **Lenders:** The Borrower is also a customer of the syndicate participants.
 - **Agent:** The Agent's customers are the Borrower and the Lenders.

Customer due diligence

- 17.9 The mandated Lead Manager/Arranger/Bookrunner should apply the guidance set out in Part I, Chapter 5, and in particular, the guidance on multipartite relationships in Part I, section 5.5, in line with the firm's risk-based approach, to the Borrower and to the Agent.
- 17.10 The Agent should apply the guidance set out in Part I, Chapter 5, in line with the firm's risk-based approach, to the Borrower and the Lenders. The Agent, where as part of its risk-based approach it feels it is appropriate to do so, may take account of the due diligence carried out by the mandated Lead Manager/Arranger/Bookrunner on the Borrower. It is often the case that the lenders have pre-existing relationships with the mandated Lead Manager/Arranger/Bookrunner and/or the Agent so that, in practice, little, if any, additional due diligence will need to be undertaken.
- 17.11 The Lender also has a responsibility to apply the guidance set out in Part I, Chapter 5, subject to the firm's risk-based approach, to the Borrower, including where the Lender feels it is appropriate to do so, taking account of the due diligence carried out by the mandated Lead Manager/Arranger/Bookrunner on the Borrower.
- 17.12 As the mandated Lead Manager/Arranger/Bookrunner and Agent also have an obligation to verify the identity of the Borrower, the Lender may, where as part of its risk-based approach it feels it is appropriate to do so, take account of the due diligence carried out by the mandated Lead Manager/Arranger/Bookrunner and/or Agent on the borrower where they are in a comparable jurisdiction. In such instances it may be appropriate for the reliance arrangements to be confirmed in a certificate to the Lenders stating that the CDD has been undertaken and documentation is available on request. This may be facilitated by the Borrower undertaking to provide all relevant CDD documentation as set out in Part I, Chapter 5 of this guidance.
- 17.13 Where the Borrower has provided a guarantor as part of the loan agreement, all parties who have an obligation to identify the Borrower - mandated Lead Manager/Arranger/Bookrunner, Lenders and Agent - should consider whether it is necessary, based upon their risk-based approach, to apply to the guarantor the verification procedures they are applying to the Borrower.
- 17.14 The money laundering risk associated with a guarantor only becomes real if a borrower defaults on a loan, and the guarantor is called upon to repay the loan. A firm may consider, subject to its risk-based approach, whether it should verify the identity of the guarantor at the same time as the Borrower, or only to identify the guarantor as and when the guarantor is called upon to fulfil his obligations under the loan agreement.
- 17.15 When considering the extent of verification appropriate for a particular borrower, any normal commercial credit analysis and reputational risk assessment and background checks that have been undertaken on the Borrower should be taken into account, and should be factored into a firm's risk-based approach.

Secondary market in syndicated loans

- 17.16 A Lender under a syndicated loan may decide to sell its participation in order to: realise capital; for risk management purposes, for example to re-weight its loan portfolio; meet regulatory capital requirements; or to crystallise a loss. The methods of transfer are usually specified in the Syndicated Loan Agreement.
- 17.17 The most common forms of transfer to enable a Lender to sell its loan commitment are: novation (the most common method used in transfer certificates to loan agreements); legal assignment; equitable assignment; fund participation and risk participation. Novation and

legal assignment result in the Lender disposing of its loan commitment, with the new lender assuming a direct contractual relationship with the Borrower, whilst the other methods result in the Lender retaining a contractual relationship with the Borrower and standing between the purchaser in the secondary market and the Borrower. The transfer method should be taken into account by the purchasing firm when considering its customer due diligence requirements.

Customer due diligence

- 17.18 A firm selling a participation in a loan should apply the guidance set out in Part I, Chapter 5, in line with its risk-based approach, when identifying, and if necessary verifying the identity of, the purchaser.
- 17.19 A firm purchasing a participation in a loan should apply the guidance set out in Part I, Chapter 5, in line with its risk-based approach, when identifying, and if necessary verifying the identity of, the seller.
- 17.20 The money flows are between the purchaser and seller of the loan. However, if a firm purchases a participation in an existing loan from another participant by way of novation or legal assignment, it will have a direct contractual relationship with the Borrower. As such the purchaser has an obligation to identify, and if appropriate as part of its risk-based approach verify the identity of the Borrower, in accordance with the guidance set out in Part I, Chapter 5.
- 17.21 Where a firm purchases a participation in an existing loan from another participant (the Lender) by way of equitable assignment, fund participation or risk participation the seller acts as intermediary between the purchaser and the Borrower for the life of the loan. Depending on the status of the Lender (seller), the purchaser should decide as part of its risk-based approach whether it has an obligation to identify, and verify the identity of, the Borrower, in accordance with the guidance set out in Part I, Chapter 5.
- 17.22 In addition, a firm purchasing a loan in the secondary market must check the underlying Borrower against HM Treasury's Consolidated List.
- 17.23 Whether the Agent is required to undertake customer due diligence on a secondary purchaser of a loan participation will depend upon how the transfer between the seller and the purchaser in the secondary market is made:
- Where the sale is by way of novation or legal assignment the Agent should, as part of its risk-based approach, identify, and verify the identity of, the purchaser, in accordance with the guidance set out in Part I, Chapter 5.
 - Where the sale is by way of equitable assignment, the Agent may not have a direct relationship with the purchaser, even though funds may flow through the Agent from or to the purchaser (via the Lender), and therefore the Agent may not have an obligation to identify and/or verify the purchaser. However, the Agent should consider, as part of its risk-based approach, whether it should identify, or verify the identity of, the purchaser in accordance with the guidance set out in Part I, Chapter 5 and check them against HM Treasury's Consolidated List.
 - Where the sale is by fund participation or risk participation, the Agent will not necessarily be aware of the transaction and therefore has no obligation to identify and/or verify the purchaser or check them against HM Treasury's Consolidated List.