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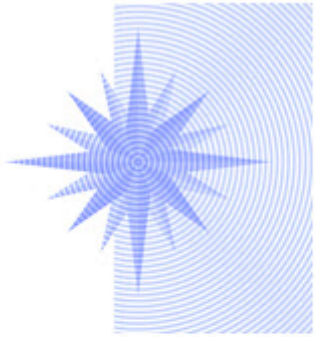

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Wolfsberg Frequently Asked Questions ("FAQs") on Selected Anti-Money Laundering Issues in the Context of Investment and Commercial Banking

Preamble

The Wolfsberg Group of International Financial Institutions (the "Wolfsberg Group")[1] has published global anti-money laundering ("AML") guidance, statements and principles with regard to private banking, correspondent banking, terrorist financing, monitoring pooled vehicles and the risk based approach. Whilst the Wolfsberg Group has not (until now), addressed investment banking or commercial banking per se, much of the published guidance is also relevant to these business segments. However, certain aspects of the business undertaken by financial institutions engaged in Investment and Commercial Banking (referred to hereafter as "Financial Institutions") raise specific AML questions, in particular regarding:

- who is the Financial Institution's customer in common transaction scenarios;
- who should conduct due diligence on the customer in certain scenarios;
- what level of due diligence should be conducted in such scenarios (including particularly whether a Financial Institution should "drill down" when dealing with certain types of customers such as institutional intermediaries and conduct any due diligence on their customer's customers); and
- the Financial Institution's role in common and complex transactions.

The following FAQs seek to address some of these questions and contain guidance that may be applied by Financial Institutions in the context of a reasonable risk-based approach to AML matters. These FAQs do not supersede applicable laws and regulations where they are more stringent.

[1] The Wolfsberg Group consists of the following leading international financial institutions: ABN AMRO, Banco Santander, Bank of Tokyo-Mitsubishi-UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Société Générale, and UBS.

These FAQs were prepared by the Wolfsberg Group in association with RBC Financial Group and SEB Group.

Definition of Investment Banking and Commercial Banking and Scope of these FAQs

For the purposes of these FAQs, investment banking and commercial banking are viewed as wholesale businesses. The clients and counterparties are corporate or institutional in nature. Retail brokerage, retail banking, private banking, and correspondent banking are not within the scope of these FAQs. More specifically, investment banking and commercial banking, whether conducted in a bank, broker-dealer or other entity, include, but are not limited to, the following activities: mergers and acquisitions; IPOs/underwriting; trading (including securities, derivatives, currencies, commodities); and credit/lending (including syndicated facilities). These FAQs consider selected issues with regard to these activities, as well as certain ancillary or "downstream" activities that merit consideration, namely, the activities of: administration companies (including transfer agents) supporting fund managers and funds; syndicated loan lenders, arrangers and agents; and paying agents and trustees with respect to debt securities.

The FAQs below are grouped under several headings:

A. Beneficial ownership, institutional intermediaries, and private funds;
B. Investment banking and commercial banking transactions generally;
C. Loan syndications, participations and trading;
D. Letters of credit; and
E. Other questions: custody; paying agents and corporate trustees; and escrow agents.

A Risk-Based Approach

It should be noted that, although investment banking and commercial banking have not historically been regarded as associated with money laundering risk, a Financial Institution should assess its customers for AML purposes using a risk based approach to determine the appropriate level and degree of due diligence[2] to be applied; these FAQs are predicated on the application of the risk based approach to customer relationships, interaction with other third parties and transactions executed by Financial Institutions. Factors generally relevant to risk-assessing customers are considered in the Wolfsberg Guidelines on a Risk Based Approach for Managing Money Laundering Risks.

Management and Monitoring of Client Relationships Generally

A Financial Institution should consider the role of its relationship managers in the client acceptance process. One relationship manager may have responsibility for the acceptance process with respect to a particular client, but it may not make sense for that relationship manager to continue to be responsible at all times for that client if, the client's activities with the Financial Institution change over time. Additionally, a client may be referred to the

[2] These FAQs generally use the term "due diligence" rather than "know your customer" (or "KYC") because a Financial Institution may sometimes conduct due diligence on a third party who is not a "customer", for example, with respect to a counterparty or partner in a deal (e.g., private equity firm, venture capital fund), so that the term "know your customer" is not really applicable. In these FAQs, the term "due diligence" may include identification, verification, or such other scrutiny as the Financial Institution deems appropriate to comply with applicable regulation or to manage AML and reputation risk (e.g., to satisfy itself that risks to its reputation from association with such customers or parties is minimised).

investment bank or commercial bank from another business unit that originally accepted the client and/or, the relationship manager responsible for one aspect of the client's business may move to another position within the firm. Finally, it may not be realistic to expect one relationship manager to monitor all business conducted by a particularly large or globally active client throughout a large or international institution. Rather, in such cases, there may be different relationship managers at any one time who have responsibility for the business activities of one client throughout different business or product units in the firm.

The Financial Institution should consider how to address the management of its client relationships in such contexts; how client information is received, updated, and made available to appropriate relationship managers; and how it would apply its monitoring policies and procedures with respect to such clients.

Monitoring of investment banking and commercial banking activities for money laundering should take into account the ways that such activities may involve money laundering practices that are different from those seen in other areas. It may be more appropriate to focus on clients rather than transactions because the nature of investment banking or commercial banking transactions may make it difficult to define general transaction parameters. Additionally, while money laundering traditionally involves the attempted transformation of illicit funds to "clean" funds, certain capital markets transactions may be initiated with clean money, but ultimately involve proceeds that are illicit because they are the product of illegal activities. Accordingly, when transaction monitoring leads to identification of transactions that may be unusual in this respect, such transactions should also be considered for their money laundering implications.

Certain criminal activity that may be carried out through an investment banking firm could give rise to money laundering concerns, but could also be subject to other requirements relating to market abuse and insider dealing. For example, a transaction entered into shortly prior to a significant incident such as a terrorist attack which appears to anticipate a fall in the market may be considered suspicious and therefore be reportable as a money laundering suspicion. However, such trading is covered in most jurisdictions by legislation relating to the use of inside information. Whilst there is an overlap between the two types of offences, these FAQs do not deal with indications of market abuse and insider dealing.

Part A: Beneficial Ownership, Institutional Intermediaries and Private Funds

A Financial Institution should, as a matter of general principle, use a risk-based approach in performing due diligence with respect to its customers, and to the extent appropriate, "beneficial owners" of, or persons who exercise control over, its customers. The FAQs below specifically consider when, in a number of contexts, it is appropriate to perform due diligence with respect to beneficial owners.

Q1. Under what circumstances is it appropriate for a Financial Institution to perform due diligence with respect to the persons who exercise control over customers that are operating companies[3]?

[3] The term "operating company," as used in these FAQs, refers to commercial enterprises generally, such as manufacturing and industrial companies, grain traders, transport companies, utilities, software designers, etc. The term could also include not-for-profit enterprises such as hospitals, university endowments, etc. Operating companies are to be distinguished, for purposes of these FAQs, from institutional intermediaries and private funds, which are given additional consideration below.

Investment banking and commercial banking customers include operating companies, which usually take the legal form of corporations, but may also include, e.g., limited liability companies, limited partnerships, etc. A guiding principle in "knowing" such customers is to know, where appropriate, who exercises ultimate control over the customer. Except in cases where an operating company is determined to be sufficiently "transparent" as described below, appropriate due diligence should generally be performed on persons exercising the requisite level of control (as determined in accordance with the next paragraph) over the customer. Generally, such due diligence may entail verification of identity through documentary or other means, although a Financial Institution may wish to consider, using a risk-based approach, whether there are circumstances where doing so might not be warranted.

Consistent with the requirements of local law, a Financial Institution should determine, using a risk-based approach, which persons exercise control over a company. Relevant in this regard is the extent of such persons' ability to influence directly the actions of a company or to make policy with respect to a company. Usually, control is exercised by members of senior management (which may include directors in some situations), and a Financial Institution should ascertain who those individuals are. Control can also be a function of the level of ownership in a company. Ascertaining the identity of persons having control by virtue of their ownership interest in the company, frequently referred to as "beneficial owners," goes beyond immediate levels of corporate ownership to ultimate natural persons whose beneficial ownership exceeds a level that confers control. In cases of both senior management and beneficial owners who exercise control, due diligence includes determining, in relevant cases, whether such persons are "politically exposed persons."

Where a company is transparent by virtue of its being a "public" company, or a majority owned direct or indirect subsidiary of a public company[4], it would not be necessary or appropriate to drill down into beneficial ownership or to those persons who exercise control over such a company. Further, it would not be necessary or appropriate to drill down into beneficial ownership in the event that a company's ownership is sufficiently dispersed so that no one beneficial owner exerts control (which may frequently be the case for large companies, even if they are not listed or publicly traded, etc.). Largeness by itself may entail various mechanisms ensuring transparency such that a Financial Institution may give consideration to treating sufficiently large reputable operating companies as "public" companies, even though they technically do not come within the definition of public company set out in footnote 4.

Certain types of companies, namely, institutional intermediaries and private funds are given additional consideration below.

[4] "Public company," as used in these FAQs, means a company that is (i) listed on an exchange or (ii) registered with an appropriate governmental authority or (iii) under the regulatory supervision of the local authority or (iv) owned by a government; provided that the exchange, governmental authority, regulator or government meets the financial institution's relevant risk-based criteria. For the purposes of (ii) of this definition, a governmental authority may be deemed "appropriate" if registration with such authority results in the requisite level of transparency as to the business of the company and as to control and beneficial ownership. If registration entails sufficient measures promoting transparency (e.g., disclosure, audit, governance requirements), a Financial Institution may be in a position to determine that such a registration regime may provide sufficient information to satisfy their due diligence obligations. These FAQs, however, do not recommend that all companies in a particular jurisdiction should necessarily be subject to this level of regulation. In any event, it is recommended that governments establish registries within their jurisdictions that will provide information on control and beneficial ownership.

Q2. How should a financial institution perform due diligence with respect to an institutional intermediary?

For the purposes of these FAQs, the term "institutional intermediary" refers to financial institutions such as banks, broker-dealers, investment advisers and other institutional entities that, when they transact with the Financial Institution, act on behalf of their customers.[5] Many investment and commercial banking customers are institutional intermediaries. A Financial Institution should determine the circumstances in which it may be reasonable to assume that an institutional counterparty, in its relationship with the Financial Institution, is acting as an institutional intermediary. "Knowing" an institutional intermediary entails consideration of a number of factors that would not generally be relevant in the context of operating company customers, including the following:[6]

- Whether the institutional intermediary, based on the level of regulatory supervision to which it is subject and the jurisdiction in which it is based, is subjected to adequate AML regulation in the context of its dealings with clients and is supervised for compliance with such regulation.[7]

- Whether, even if the institutional intermediary is not subjected to adequate regulation as set forth in the prior bullet, the institutional intermediary applies AML (including customer due diligence) procedures that are equivalent to those of institutional intermediaries subject to money laundering regulation that is deemed adequate. (Example: the client's parent is subjected to adequate regulation as set forth in the prior bullet and applies global procedures).

Generally, if the Financial Institution can determine, using its based-based approach, that an institutional intermediary is subjected to adequate AML regulation in accordance with the criteria set forth in the first bullet above, the Financial Institution may presume the institutional intermediary's AML procedures to be of an acceptable standard. A Financial Institution may ascertain whether an institutional intermediary is subject to AML regulation, and whether it has implemented an AML program in accordance with such regulation, on the basis of representations furnished by such intermediary. However, if the institutional intermediary cannot be determined to be subject to adequate AML regulation as set forth in the first bullet above, then the Financial Institution should consider--and different Financial Institutions may develop different approaches in this regard--what steps it might take to mitigate money laundering risk. As noted in the example in the second bullet above, this might include considering the possible relationship of the institutional intermediary to a parent that is subjected to adequate AML regulation (and whether the institutional

[5] In general parlance, banks or broker-dealers, even if they are acting on a proprietary basis, may be referred to as "intermediaries," because they typically have funds or other assets (e.g., deposits) furnished by others. However, for purposes of these FAQs, the term "institutional intermediary" will more narrowly refer to institutional counterparties that act on behalf of their clients. Institutional counterparties acting on a proprietary basis are considered in Q3.

[6] Whether to perform due diligence on the beneficial owners, e.g., the shareholders of the institutional intermediary, should be approached in the same manner as described above with reference to operating companies. For instance, if the institutional intermediary is a corporation listed on an exchange meeting the Financial Institution's relevant criteria, there is no need to drill down to the shareholders of the institutional intermediary. Moreover, if the institutional intermediary is regulated in a low risk jurisdiction and subject to that jurisdiction's AML regulation, then there would be no need to drill down into ownership either.

[7] Such a determination may be based on a Financial Institution's general risk assessment methodology, which may take into account the regulatory supervision of institutional intermediaries in particular jurisdictions, and would not necessarily entail discrete inquiries into the level of regulation of particular institutional intermediaries on a case-by-case basis.

intermediary applies global policies) or satisfying itself as to the adequacy of the institutional intermediary's AML procedures. See also the answer to Q5 below as to steps a Financial Institution should consider taking, if it is of the view that it may not be able to sufficiently mitigate AML risk in this manner.

In addition, the Financial Institution should satisfy itself as to the institutional intermediary's reputation based on publicly available information and as to such other matters regarding the institutional intermediary as it deems appropriate (including, as appropriate: the nature of the institutional intermediary's business and markets; the type, purpose and anticipated activity of the account; and the nature and duration of the Financial Institution's relationship with the institutional intermediary).

See the answer to Q5 below for a discussion as to the appropriate course of action in the event that the financial institution cannot satisfy itself as set forth above.

Q3A. How should a Financial Institution perform due diligence with respect to an institutional counterparty acting on its own behalf (which is not, therefore, an "institutional intermediary," as the term is used in these FAQs)?

Where an institutional counterparty is acting on its own behalf, a Financial Institution should apply the same criteria to it that it would apply to an institutional intermediary (see Q2 above). The Financial Institution would not necessarily need to review the specific AML procedures of the institutional counterparty, acting on its own behalf.

Q3B. Should a Financial Institution perform due diligence on the customers of such an institutional counterparty?

No.

Q4. Should a Financial Institution perform due diligence on the customers of an institutional intermediary in the event that the institutional intermediary is acting on their behalf? Which is to say, are customers of an institutional intermediary to be treated as customers of the financial institution for AML purposes?

In appropriate circumstances, no.

(1) When the Financial Institution, applying its risk-based approach, determines, based on the level of regulatory supervision to which the institutional intermediary is subject and the jurisdiction in which the institutional intermediary is based, that the institutional intermediary is subjected to adequate AML regulation in the context of its dealings with its clients and is supervised for compliance with such regulation. The obligation to "know your customer" extends only to the Financial Institution's customers, in this case, the institutional intermediary. Accordingly, there is no need to drill down through the institutional intermediary to identify and conduct due diligence on the institutional intermediary's customers, subject to satisfactory due diligence being carried out with respect to the institutional intermediary as set forth in the answer to Q2.[8] As a general matter, the

[8] In keeping with this principle, it would be inappropriate to view the Financial Institution as having an obligation, albeit one that may delegated, to conduct due diligence with regard to the institutional intermediary's customers. Accordingly, the Financial Institution should not be viewed as "relying" on the institutional intermediary to conduct due diligence on the institutional intermediary's customers.

customers of an institutional intermediary on whose behalf the intermediary is acting are not, and do not become the customers of the Financial Institution.[9]

Similarly, it would be inappropriate to view an institutional intermediary's customer as having a beneficial ownership interest with respect to transactions entered into between the institutional intermediary and the Financial Institution. Even if there is a notional connection between funds the customer entrusts with an institutional intermediary and transactions that the institutional intermediary enters into with a Financial Institution, that nexus should not result in the institutional intermediary's customer being treated as the customer of the Financial Institution.[10]

(2) When the Financial Institution cannot make the determination regarding the institutional intermediary as set forth in (1) above. Under these circumstances, the Financial Institution should consider what steps it might take to mitigate money laundering risk. Applicable law may require Financial Institutions to do a measure of due diligence with respect to the customers of the institutional intermediary, even though the customers of the institutional intermediary are not customers of the Financial Institution. However, subject to compliance with applicable law, there may be circumstances in which a Financial Institution can satisfy itself as to relevant factors, using a risk based approach, so that, it would be reasonable for the Financial Institution not to ascertain the identity of the institutional intermediary's customers or to conduct other due diligence with respect to such customers. Such factors include those set forth in answer to Q2 above, as well as the nature, location, and number of the institutional intermediary's customers (a customer base consisting of a larger number of low risk customers on behalf of whom the institutional intermediary is acting generally posing less risk than a customer base consisting of a small number of high risk clients). [11]

With regard to situations in which the Financial Institution cannot satisfy itself with respect to the institutional intermediary, see the answer to Q5 below.

[9] This situation is to be distinguished from one in which an institutional intermediary "introduces" its customer to a Financial Institution, which then opens an account directly with the Financial Institution and accordingly becomes the customer of the Financial Institution.

[10] An institutional intermediary may open an omnibus account with a Financial Institution that does not entail disclosure of the identity of the institutional intermediary's clients. However, such an intermediary may also establish an account with a Financial Institution that specifies sub-accounts on behalf of the intermediary's customers. The sub-accounts may have standing delivery instructions and may bear names of such customers for administrative purposes. However, if all actions with regard to the sub-accounts are initiated by the intermediary, and its customers have no direct control over the sub-accounts, the customers of the institutional intermediary would not be treated as customers of the Financial Institution, for AML purposes, even though the Financial Institution may have performed a credit analysis with respect to such sub-accounts or checked the names of sub-accounts against sanction lists.

[11] Even if the Financial Institution reasonably applies a risk-based approach in assessing an institutional intermediary and in reasonably concluding that it need not drill down to the institutional intermediary's customers, one or more of institutional intermediary's customers and their transactions may nonetheless ultimately be found to be illicit by law enforcement and even with the use of a reasonably designed risk based approach, a Financial Institution may unwittingly be involved in money laundering. Such a finding does not invalidate the risk based approach and should not result in unwarranted criticism of a Financial Institution that has implemented such an approach. See the Wolfsberg Principles on a Risk-Based Approach for Managing Money Laundering Risks.

Q5. How should a Financial Institution proceed if it cannot satisfy itself with respect to a client that is (i) an institutional intermediary or (ii) an institutional counterparty acting on its own behalf?

If the Financial Institution cannot satisfy itself with respect to an institutional intermediary acting on behalf of its customers, then the Financial Institution should (i) conduct appropriate due diligence with respect to the customers on whose behalf the institutional intermediary is acting, or (ii) decline to do business with the institutional intermediary. If the Financial Institution cannot satisfy itself with respect to an institutional counterparty acting on its own behalf, then the Financial Institution should decline to do business with it.

Q6. On whom should a Financial Institution perform due diligence in the context of a private fund? Should a Financial Institution perform due diligence with respect to investors in a private fund?

Private funds raise unique AML concerns. Such funds, to be distinguished from publicly traded or registered mutual funds, include private equity funds (typically used to raise funds to finance a range of businesses) and hedge funds (typically used to raise funds to engage in a variety of investment activities). While private funds may take a corporate form, they are not operating company customers for due diligence purposes. In the event there are a small number of investors, the question could theoretically arise as to whether such investors exert a level of control over the fund that warrants performing due diligence with respect to such investors, i.e., whether there should be drill down to that level of ownership. The situation could, arguably, be likened to that of vehicles established by clients who are beneficial owners of such vehicles and who exercise control over those vehicles.[12]

Private funds are, however, typically distinguishable from vehicles used as instruments or "alter egos" in that they:

- are not usually mere instruments of the investors, but, rather, are managed by an institutional entity that is distinct and separate from the investors in the fund:
- may be subject to AML regulation:
- may be supervised as to compliance with respect to such regulatory requirements:
- may have AML policies and procedures: or
- may otherwise be considered reputable by the Financial Institution .

In this respect, private funds are like institutional intermediaries, and the conclusion may be drawn that in the appropriate circumstances, a Financial Institution will not need to drill down to investor level.

The factors that determine whether need for drill down to the investors in the private fund may be obviated are (see also Q2 and 4):

[12] Such vehicles, frequently taking the form of trusts or personal holding companies, are instruments, "alter egos," as it were, of the beneficial owners. In accordance with sound KYC principles, in the context of investment banking and commercial banking, the due diligence focus with respect to such vehicles should be on those clients/beneficial owners with reference to ascertaining and verifying identity and determining source of funds. See the Wolfsberg Anti-Money Laundering Principles on Private Banking and related Frequently Asked Questions for a consideration of these issues in the context of private banking.

- The private fund is determined by the Financial Institution, applying its risk based approach, to be subject to adequate AML regulation and to be supervised for compliance with such regulation; and
- the private fund is considered reputable by the financial institution on the basis of publicly available information (and the absence of information that would call into question the reputation of the private fund).

Similarly, if the private fund structure involves an advisor, administrator, or transfer agent that meets the criteria set forth above in this paragraph, then drilling down to the investors would not be warranted, even though the Financial Institution's relationship may be directly with the fund itself. The Financial Institution should consider entering into an agreement with the advisor, administrator, or transfer agent to address such regulatory requirements as may be applicable to it.

The analysis would be more nuanced in the event neither the fund nor any other related party is regulated as to money laundering nor indeed, is regulated at all, or is not supervised in this regard. In any of these situations, the Financial Institution should consider whether there are other aspects that might mitigate money laundering risk. Applicable law may require Financial Institutions to do a measure of due diligence with respect to investors in the fund. However, subject to compliance with applicable law, there may be circumstances, in which a Financial Institution can satisfy itself as to relevant factors, using a risk based approach, so that it would be reasonable for the Financial Institution not to drill down to ascertain the identity of the investors or to conduct other due diligence with respect to them. Such factors include those set forth in Q2 above, as well as: possible membership in self-regulatory organizations or trade associations that prescribe AML principles; the nature of the intermediaries through which the fund may be distributed (when distribution is only through intermediaries that are adequately regulated as to AML, there would be less risk than when the funds are distributed through intermediaries that are not so regulated and supervised); the nature, location and number of the fund's investors (a large number of low risk investors generally posing less risk than a small number of high risk investors, one or more of which may be in a position to exercise control with regard to the fund) and the reputation of the relevant participants.[13]

If the Financial Institution cannot satisfy itself as to these matters, it should either decline the account or ascertain the identity of the investors and perform due diligence with respect to them.

[13] Even if the Financial Institution reasonably applies a risk-based approach in assessing a fund, advisor or other participant in the structure and in concluding that looking through to the fund's investors may reasonably be obviated, the fund's investors and their transactions may nonetheless ultimately be found to be illicit by law enforcement, and even with the use of a reasonably designed risk based approach, a Financial Institution may unwittingly be involved in money laundering. Such a finding does not invalidate the risk based approach and should not result in unwarranted criticism of the Financial Institution that has implemented such an approach.

Part B: Investment Banking and Commercial Banking Transactions Generally

Investment banking and commercial banking transactions, such as typical bond or equity offerings, tend to be transparent and are not generally associated with money laundering activity. However, transactions could entail money laundering risk, as well as reputation risk, because of an underlying fraud or otherwise. A number of questions may arise in this context.

Q1. What is a Financial Institution's responsibility with respect to transactions it engages in with investment banking and commercial banking clients?

In addition to knowing the customer, a Financial Institution should understand the structure of a proposed transaction and its purpose, and should determine whether the purpose of the transaction is consistent with its structure and whether the transaction makes economic sense. In the event that the Financial Institution cannot make these determinations, it should either obtain more information so that it can do so satisfactorily or not proceed with the transaction.[14] If unusual or suspicious activity is encountered in making these determinations, the matter should be escalated in accordance with the Financial Institution's procedures.

Q2. How should a Financial Institution make this determination in the context of complex transactions?

A Financial institution should define those characteristics of complex structured financing that warrant subjecting such transactions to additional review in making the determinations referred to in Q1 above, namely, those transactions that are likely to pose a higher than average risk to a financial institution. It is understood that many transactions, e.g., credit card securitizations, may entail considerable complexity, yet be fundamentally transparent. Some complex structured financings may involve "special purpose vehicles" ("SPVs"), without affecting transparency. Such transactions are unlikely to pose higher than average risk.

Additional review of less transparent transactions would be conducted by more senior levels of the relevant business unit and, when warranted, by a designated group of experts (including, for example, senior risk management, compliance, tax, accounting and legal experts, as well as business persons).

Q3. What should a Financial Institution do to enable its employees to make the determinations described in response to the prior question?

The Financial Institution should address the principles noted in response to Questions 1 and 2 above in its policies and procedures. In addition, the Financial Institution should provide training to appropriate employees to enable them to make the relevant determinations and to escalate matters when appropriate. Such training could include pertinent case studies. Managers should supervise the activities of their employees to assure that such employees are making these determinations appropriately and escalating in accordance with the Financial Institution's procedures.

[14] Even if such transactions appear to be unusual, they may not be unusual in the way more conventional money laundering schemes might be and typical money laundering "red flags" might be absent from these transactions.

Part C: Loan Syndications, Participations and Trading

Loan syndications and loan trading are not generally associated with money laundering activity. Questions do arise, however, as to the AML responsibilities of Financial Institutions in this context.

Q1. Which parties in a loan syndication should perform due diligence with respect to the borrower or lenders at the time the loan is initially syndicated?

The lenders in a loan syndication (including participants and assignees in the primary syndication[15]) have the responsibility to conduct due diligence with regard to the borrower. The borrower may provide relevant information (e.g., organisational documents, annual reports) to the lenders through the arranger or agent, and the lender could use such documents for due diligence purposes (including customer identification) as appropriate. Identity may, however, be verified on a non-documentary basis, and lenders may obtain relevant information from other sources. The lenders do not have a due diligence obligation with respect to each other, nor does the arranger or agent have such an obligation with respect to the borrower solely by virtue of its capacity as arranger of, or agent under, the credit facility.

However, the arranger or agent should have procedures to perform an appropriate level of due diligence with regard to lenders that it invites to join the syndicate. It is understood that such lenders typically have pre-existing relationships with the arranger or agent, so that little, if any, additional due diligence need be performed in this regard in the context of particular transactions.

Q2. Should loan participants and assignees in the secondary market perform due diligence with respect to the borrower?

As stated above, lenders should perform due diligence with respect to a borrower in connection with the making of a loan, as should participants and assignees at the time of the primary syndication. However, assignees and participants in the secondary market, after the primary syndication, may not be in a position to detect and prevent money laundering. It would not be a reasonable use of resources for loan participants and assignees to perform such due diligence or to be viewed as subject to an obligation to perform such due diligence. Secondary market loan transactions may be analogized to secondary market bond trades, where it is well understood that bond purchasers do not have due diligence obligations vis-à-vis issuers. Secondary market loan transactions are not generally associated with money laundering risk.

However, there may be circumstances (e.g., when a loan participant or assignee becomes aware, in the ordinary course of its relationship with the borrower, of a fundamental change in the borrower's ownership or business) in which a Financial Institution should consider

[15] "Assignments" generally contemplate the transfer of rights or of rights and obligations; sometimes the transfer of rights and obligations is referred to as a "novation." The term "assignment," for the purposes of these FAQs, includes both assignments and novations. These transfers are on a disclosed basis, which is to say that the agent is informed of the transfer. A "participation" (sometimes referred to as a "sub-participation") is assumed, for purposes of these FAQs, to be on an undisclosed basis, which is to say that the agent is not informed of the transfer. Transfers of participations on a disclosed basis should, for purposes of these FAQs, be treated as assignments.

performing due diligence with respect to the borrower, and it should use a risk-based approach in identifying such circumstances. Moreover, as a general matter, if, in the ordinary course of its relationship with the borrower, the loan participant or assignee becomes aware of unusual activity in connection with the transaction, it should seek clarification with regard to the transaction, and, if its concerns are not dispelled, should escalate the matter in accordance with the loan participant's or assignee's escalation procedures to determine whether the activity is suspicious and therefore to be reported.

Q3. Should the seller of the loan perform due diligence with respect to the participant or assignee and vice versa?

The lender selling a participation or assignment should, in accordance with the lender's due diligence policies and in keeping with a risk based approach, have procedures to perform due diligence with respect to the participant or assignee, and vice versa. It is understood that the parties to a loan participation or assignment typically are institutional and have pre-existing relationships such that little, if any, additional due diligence is required in this regard in the context of particular transactions.

Q4. Should the agent perform due diligence with respect to assignees purchasing loans in the secondary market?

There may be situations in which an agent would not be in a position to transfer funds to, or receive funds from, an assignee, because, for example the assignee is subject to sanctions. The agent may have AML concerns about prospective assignees. A Financial Institution that will be an agent for a syndicated loan should consider having provisions included in the relevant loan documentation that would permit it to take such concerns into account and to allow it not to effectuate an assignment on the basis of such concerns.

Q5. What is the agent's role with regard to participants buying loan participations in the secondary market?

Although the seller of the loan participation should perform due diligence with respect to the participant, the agent need not do so (indeed, it would not be able to do so because it ordinarily would not know to whom participations are sold), nor need the agent seek a contractual consent right with respect to participations.

Part D: Letters of Credit

Letters of credit are frequently used in connection with import and export transactions. The FAQs below consider a number of common cases in this area. It should be noted that there is a considerable variety of products and structures in this area, and the application of the general principles expressed below may be subject to exceptions to reflect the particular circumstances of these different products and structures.

Q1. When a bank issues a letter of credit, who should it treat as its customer for due diligence purposes? What should the issuing bank consider with respect to particular transactions?

Generally, the issuing bank should treat the applicant (the buyer) as its customer. In this regard, the issuing bank would consider a number of transaction-related matters, including whether the transaction involves goods that are recognizably outside the scope of the

customer's business or whether the transaction is otherwise unusual for its customer, whether the prices are manifestly out of line with market prices (assuming the relevant letter of credit staff of the issuing bank is aware of market prices on the basis of its general knowledge), whether the goods involved warrant a greater level of consideration (e.g., military equipment), and whether such confirming/advising bank as may be designated by the applicant is reputable. If the issuing bank discerns something sufficiently unusual about the transaction, it should seek clarification about the matter and, if the explanation is insufficient to dispel concerns with regard to the transaction, the issuing bank should escalate it in accordance with its procedures. The issuing bank has no AML due diligence obligations with respect to the beneficiary or advising/confirming bank.

Q2. When a bank confirms or advises a letter of credit, who should it treat as its customer for due diligence purposes?

Generally, the confirming and, except as provided in the next sentence, the advising bank should treat the issuing bank as its customer. In some circumstances, the beneficiary may be the customer of the advising bank, and, in such cases, the advising bank should already have focused its due diligence on the beneficiary. In cases where the bank to whom the beneficiary presents documents is a nominated bank that neither advised nor confirmed the letters of credit, the nominated bank should treat the beneficiary as its customer.

In general, the relationship of the confirming bank to the issuing bank is comparable to that of a financial institution to a correspondent bank. Accordingly, the confirming bank or, when appropriate, the advising bank should consider, as part of the due diligence process vis-à-vis the issuing bank, the factors described in the Wolfsberg Correspondent Banking Principles and related FAQs.. The confirming bank would ordinarily not be viewed as having due diligence obligations with respect to the applicant or beneficiary, nor would the advising bank, except, as noted above, when the beneficiary, rather than the issuing bank, is the customer of the advising bank.

However, (i) if the confirming/advising bank discerns something sufficiently unusual about a transaction, based on its general experience with letters of credit, or (ii) if the nominated bank (whether it advised or confirmed the letter of credit or not) discerns something sufficiently unusual, based on its review of the documents submitted to it, then, in the case of either (i) or (ii), it should seek clarification about the matter and, if the explanation is insufficient to dispel concerns with regard to the transaction, the confirming/advising/nominated bank should escalate it in accordance with its procedures. Even if the documents appear to be in order, but the nominated bank becomes aware of something sufficiently unusual about the transaction, then it should also seek clarification about the matter and, if appropriate, escalate it in accordance with its procedures.

Part E: Other Questions: Custody; Paying Agents and Corporate Trustees and Escrow Agents

Q1. What is a Financial Institution's AML responsibility with respect to free transfers of securities on behalf of custody clients, i.e., transfers of securities that are not accompanied by simultaneous transfers of funds?

Custody transactions, which typically entail both a transfer of securities and funds, should be subject to the Financial Institution's usual AML procedures. For example, the Financial Institution should perform appropriate due diligence with respect to its custody customer,

and transactions found to be unusual should be escalated in accordance with applicable procedures. This conclusion would also hold true in the context of free transfers of securities, a point that should be addressed in the Financial Institution's relevant training and awareness programs.

Q2. Who should a paying agent or corporate trustee treat as its customer for due diligence purposes?

A paying agent or corporate trustee should treat the issuer as its customer for AML purposes. Neither the underwriters, nor the bondholders, should be treated as customers of the paying agent or trustee. If the issuer is an SPV formed at the closing, the paying agent or trustee would verify the SPVs identity in accordance with the their customer identification procedures (further due diligence of the SPV in this context would not make sense), but would also perform due diligence with respect to the other parties to the transaction, i.e., the servicer or depositor (the entity transferring assets into the SPV). If the SPV is an established entity not formed at closing, the paying agent or trustee should perform due diligence with respect to the SPV in addition to verification of its identity.

Q3. What is a Financial Institution's responsibility when it functions as an escrow agent?

The Financial Institution should treat the parties to an escrow agreement as customers for due diligence purposes. (It may be that one, or more of the parties is already an existing customer of the Financial Institution). The Financial Institution should understand the structure of a proposed escrow arrangement and its purpose, and should determine whether the purpose of the escrow transaction is consistent with its structure and whether the transaction makes economic sense.