December 2006

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 102 – IMPACT OF THE THIRD MONEY LAUNDERING DIRECTIVE ON THE USE OF TRUSTS IN ISSUES OF TRANSFERABLE AND INTERMEDIATED SECURITIES

c/o Bank of England
Threadneedle Street
London EC2R 8AH
www.fmlc.org

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 102 WORKING GROUP

Bill Tudor John	Lehman Brothers
Lachlan Burn	Linklaters
Armel Cates	Clifford Chance LLP
Jonathan Fisher QC	McGrigors
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Stephen Norton	The Law Debenture Trust Corporation plc
Joanna Perkins	Secretary, FMLC
Kate Morris	Legal Assistant, FMLC

Impact of the Third Money Laundering Directive on the use of trusts in issues of transferable and intermediated securities

1 Introduction

1.1 The role of the Financial Markets Law Committee ("FMLC") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2 This paper follows two earlier papers dated 9 January 2005 produced by the FMLC Working Group in relation to the third European Anti-Money Laundering Directive (2005/60/EC) (the "Directive"). Those earlier papers were prepared to assist HM Treasury in its negotiations on the Commission proposal. They identified several difficulties that would be caused by the Directive in relation to trusts in issues of transferable and intermediated securities. In particular, they highlighted several difficulties in relation to the express arrangements that are put in place to protect bondholders by means of the appointment of a trustee. This paper summarises, in the light of the final Directive, the difficulties identified by the FMLC. Sections 2 and 3 focus on the position of bond trustees appointed under an express trust. Section 4 examines the case of other trusts which arise in the financial markets context, either by the appointment of a trustee, or by operation of the law.

2 Bond issues – A possible exemption

2.1 Historically, the role of bond trustees has been largely passive unless a default occurs.[1] This is reflected in the level of fees paid to them. The terms of the documentation of the vast number of existing bond issues in the market do not entitle trustees to require bondholders to either disclose their identities or to respond to due diligence requirements. Any system which imposed on bond trustees the obligation to ascertain and monitor the identity of the bondholders of the issue from time to time would involve the trustee in considerable time and expense which would be totally disproportionate to the level of remuneration paid to them and, in many instances, the costs would greatly exceed the amount of that remuneration.

2.2 It should be noted that the majority of bond issues in the international markets do not have a trustee representing the bondholders. It is suggested it would be anomalous if an extra layer of due diligence were imposed in the case of issues to which a trustee is appointed. As indicated in this paper there may be more apposite and efficacious ways in which due diligence can be undertaken by regulated bodies, applying equally to the primary distribution and transfers in the secondary market of bonds, whether or not the holders are represented by a trustee.

Ownership of the trust

[1] Further information on the role of the trustee in bond issuance can be found in "Issue 62 – Trustee Exemption Clauses" (FMLC, May 2004), available at www.fmlc.org.

2.3 Article 2(1)(3) of the Directive extends the requirements to undertake customer due diligence to "*(a) auditors, external accountants and tax advisors; (b) notaries and other independent legal professionals, when they participate, whether by acting on behalf of and for their client in any financial or real estate transaction, or by assisting in the planning or execution of transactions for their client concerning the: …(v) creation, operation or management of trusts, companies or similar structures*". The Directive casts a wide net. It would appear to impose obligations of due diligence in all situations in which financial and legal professionals and institutions provide services to clients, where those services relate, even tangentially, to the setting up or management of trusts or companies.

2.4 Further, Article 3(9) of the Directive defines "*trust and company service providers*" as any natural or legal person which, by way of business, provides the listed services to third parties, including: a) forming companies or other legal persons; b) acting or arranging for another person to act as a director or secretary of a company, a partner of a partnership etc; c) providing a registered office, business address etc or any other related services for a company, a partnership or any other legal person or arrangement; d) acting as or arranging for another person to act as trustee of an express trust or similar legal arrangement; and e) acting as or arranging for another person to act as a nominee shareholder for another person.

2.5 There is nothing in the Directive to suggest that "trust" here does not include all forms of domestic UK trusts, including those relating to the issue of bearer securities and to intermediation in the market for investment securities.

2.6 In a bond issue which is subject to the appointment of a trustee, the beneficiary of the trust (according to the common law use of the term – but see below paragraph 2.8ff) will be the holder of the bond. If the issue is held through a clearing system (whether in definitive or global form and whether bearer or registered) this will either be the clearing system itself (either directly, or, in some cases through nominees) or a financial institution (such as a common depositary) holding on its behalf. Customer due diligence checks should not be difficult to carry out in respect of either the clearing system itself or the common depositary. This is particularly so if the simplified arrangements set out in Article 11 are available, because the common depositary or the clearing system are financial institutions within Article 11(1). In the case of a global bond, which is in the form of a new global note where the holder is the clearing system itself, the checks are similarly simplified since one can investigate title via the registers.

2.7 However, if the bonds are in definitive form and are held outside a clearing system, it would be impossible for the trustee to carry out customer due diligence when the business relationship is established, if this means the point at which a person acquires the security (thereby becoming a beneficiary of the trust). Bearer bonds are transferred by delivery and there is no way the trustee (or anyone else, other than the buyer and the seller) can know that the purchase has taken place. With registered notes held outside the clearing system although the trustee may be able, after the event, to ascertain from the register who the registered holders are, this examination would not reveal the identity of the ultimate economic

owners of the securities since they could have been registered in the name of a nominee or custodian. It would also be commercially impracticable for a trustee to undertake a daily, weekly or monthly examination of the register for each issue of which it is trustee. Such registers may be located in any part of the world.[2] The foregoing is **Problem 1** (which is addressed below).

2.8 The position is made more difficult, whether the issue is in definitive or global form, by Article 3(6)(b) of the Directive, which extends the meaning of "beneficial owner", in the case of trusts, beyond the beneficiary in the normal English law sense to include the natural person(s) "who are the beneficiaries of 25% or more of the trust property or *who exercise control over 25% or more of the property of the trust*" (emphasis added). This is because Trust Deeds for most issues of international securities will provide to holders of securities an element of control that arguably may trigger this test. For example, the terms of most bonds will give bondholders the right to convene a meeting and will provide that, if so directed by the requisite majority of bondholders at such a meeting, the trustee must demand early repayment of the bonds after the occurrence of one of the specified events of default.

2.9 The bondholders who have these rights will include the actual holder of the bonds (or their registered owner, if the bond is in registered form). When an issue is held through clearing systems, this will usually be the clearing system itself (or its nominee) or a financial institution acting as common depositary. But Article 3(6)(b) could extend the concept of beneficial owner for these purposes to those holding interests in the bond as accountholders in the clearing systems; or, indeed, to people along the chain of economic ownership, who hold through custodians. This is because such persons are notified, through the clearing systems, of any meetings that are called and give instructions to or through the clearing systems as to how votes at the meetings should be cast. In many cases, they are also able to obtain proxy certificates enabling them to attend the meeting and to vote in person.

2.10 On this basis, the trustee may have an obligation to carry out customer due diligence checks under Article 7(a) on common depositaries, clearing systems and perhaps those who hold interests through the clearing systems because they are all, in one way or another, entitled to control the property of the trust and are therefore people with whom the trustee establishes business relationships. But there is no way that the trustee can carry out (or even know that it needs to carry out) checks when one accountholder in a clearing system transfers its interest to another, let alone when someone holding through a chain of three custodian banks transfers custody from one financial institution to another.[3] The foregoing is **Problem 2** (which is addressed below).

Payments

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[2] The same situation would pertain in relation to domestic debenture stock issues which have traditionally not been held in clearing systems.

[3] It should be noted that similar issues may arise for professional trustees in relation to other types of trustee role undertaken by them in the international financial markets. For example, a trustee holding security for a syndicated bank loan where the interests of the lenders are transferable or lenders grant sub-participations in the loans which they have made. The security trustee will have no control over the making of such transfers or the granting of such sub-participations.

2.11 Article 7(b) of the Directive requires that customer due diligence be carried out for occasional transactions amounting to €15,000 or more. From time to time, trustees will make payments that will be caught by this provision (although such payments will generally only occur following a default and will usually be made on behalf of the trustee by the paying agents).

2.12 Article 8(1)(b) requires, as part of this due diligence, that the "beneficial owner" of the customer be identified. Article 3(6) defines the beneficial owner as "the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted".

2.13 In the context of payments made by or on behalf of trustees, the "customer" for the purpose of the first part of this definition is presumably the recipient of the payment. So the obligation of the trustee or security trustee will be to check who owns or controls that recipient.[4]

2.14 The second part of the definition is, however, more difficult. The payment is the "transaction" being conducted. Accordingly, Article 3(6) would appear to require the trustee making the payment to identify the natural persons on whose behalf that payment is being collected. Where the bond is in definitive form held outside a clearing system, this should not be unduly burdensome. The person presenting a bearer security for payment, or the person who is registered as the owner of a registered security, can be asked for identification, and, if he is acting on behalf of someone else, to identify that other person.

2.15 Difficulties arise, however, where the issue is held through a clearing system. In such a case, the entire issue will typically be represented by a single global security, which is deposited either with the clearing system itself (or its nominee) or with a financial institution acting on its behalf (the "common depositary").[5] Account holders in the clearing system will be entitled, under the rules of the system, to rights in respect of the security which they will hold either on their own account, or for the account of someone else, who may either be a natural person or another intermediary. There may therefore be many layers of intermediation between the natural person referred to in Article 3(6) and the trustee of the issue, making it, for all practical purposes, impossible for the trustee to follow the chain to the natural person before making payment. The foregoing is **Problem 3** (which is addressed below).

3 Possible solutions on implementation of the Directive

Problem 1 - Customer due diligence on the issue and transfer of a definitive bond

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[4] Query whether this would mean that where the trustee knew the payment was being made to a financial institution, such as an authorised bank, it would still be necessary for the trustee to ascertain who were the ultimate shareholders of the bank or its ultimate holding company?

[5] These arrangements apply to the international clearing systems, Euroclear and Clearstream. However, other clearing systems exist where the securities may be dematerialised, so that the persons who are entitled as against the issuer to all the rights in respect of the security are the account holders in the clearing system. [This variation does not, however, affect the analysis in this paper, provided the clearing system account holders are all themselves financial institutions who are subject to the Directive or equivalent arrangements in other jurisdictions].

3.1 As indicated above, it would be impossible for a trustee to carry out customer due diligence when ownership (and therefore the beneficial interest in the trust) of a bond is transferred by a seller to a buyer in the market. Indeed, the trustee cannot even do this when the bonds are initially sold into the market, through the placing of the securities by investment banks with their clients, a process in which the trustee is not (and, because the banks regard this process as confidential) cannot be involved. Indeed, for the purposes of the Directive, it is difficult to see why they should be involved, as the placing of the securities will, in most situations, be carried out by a regulated financial institution which will be subject to money laundering obligations in any event. Any further due diligence undertaken by a trustee would merely be duplicative of the due diligence required to be undertaken by the investment bank carrying out the primary distribution of the bonds. In practice, the majority of dealings in bonds in the secondary market will be undertaken by regulated financial institutions acting for their own account or through them as intermediaries. Again, they will be subject to money laundering obligations when acting in such capacities and further due diligence by a trustee would be duplicative.

3.2 It must be presumed that laws are not intended to impose obligations that are impossible to discharge. It cannot therefore be the intention of Article 7(a) that such transfer of ownership should constitute the "establishing of a business relationship". Besides, the concepts of "establishment" and "relationship" imply an element of mutuality or consensual agreement, which cannot exist when one party to the new relationship, the trustee, is unaware that a new relationship has been created.

3.3 Even if it were possible for a trustee to carry out customer due diligence checks on initial subscription or subsequent transfer of definitive bonds, it would not be necessary for it to do so in order to achieve the purpose of Article 7(a). This is because no control over the trust property is exercised at that time. Such control is only exercised when votes are cast at meetings of security holders; and that is therefore the only point at which such due diligence checks need be carried out, on those voting at the meeting.[6]

3.4 It would also be helpful if the implementing legislation confirmed that the initial acquisition and subsequent transfer of a bond did not establish a business relationship between the acquiring bondholder and the trustee. This is because the chief occasion, other than the carrying out of occasional transactions, on which due diligence is required, is the occasion on which a business relationship is established by virtue of Article 6(a).

Problem 2 - Customer due diligence on those interested in bonds held through clearing systems

3.5 Whatever control is exercised by those holding interests in the issue through chains of intermediaries that control passes through the participants in the Approved Clearing Systems, who will all be credit or financial institutions within the scope of Article 11. Accordingly, customer due diligence checks will

[6] The documentation for existing bond issues would not confer any right on a trustee to require a holder to disclose his identity or respond to enquiries about the holder before being allowed to exercise his rights as a holder.

all be carried out at that level before any control is exercised and there should be no need for these to be duplicated by the trustee. (On this point see also 4.4 below).

3.6 Problem 2 could therefore be solved if implementing legislation provided that where securities are held through "Approved Clearing Systems", the provisions for simplified customer due diligence under Article 11(1) apply for the purposes of Article 7(a). Strictly speaking, where the issue is held in global form and the global note is deposited with a common depositary who is a financial institution within the scope of Article 11(1), these provisions should apply anyway. But where the security representing the issue is deposited with the clearing system itself (as will be the case for an issue in new global note form), it may not be clear, in every case, that the clearing system is a financial institution for these purposes, so it would be helpful to market participants for the law to remove uncertainty. The "approval" would be delegated to a ministerial or regulatory authority, through delegated legislation or rule and would be conditional: (a) on the Approved Clearing System having systems that prevent any risk of transfer to anyone other than the participants in the clearing system; and (b) the rules of the Approved Clearing System, ensuring that only credit or financial institutions falling within Article 11(1) could be participants.

Problem 3 - Payments

3.7 The role of a trustee in a bond issue has very little to do with the flow of funds from the issuer to the bondholders. Indeed, until there is a default by the issuer, the trustee has no involvement in such flows, which are made by the issuer, through its agents, to those entitled to the payments. After a default, the trustee will have a power to direct such payments to be made to it and to direct the issuer's agents to hold all payments for the trustee's account. But this is very much a power that is exercised as a last resort, and on rare occasions.

3.8 Implementing legislation could provide that for the purposes of Article 7(a), where the issue is held through an Approved Clearing System, the customer and beneficial owner is the person who holds the security (whether in global or definitive form) (either the clearing system itself or its nominee or the common depositary) and no one else.

3.9 The justification for such a measure is that the payment in question will pass from the issuer and through the Approved Clearing System without risk of diversion, and will arrive in the accounts of the participants in the Approved Clearing System. This will ensure that, although the clearing system itself may not be such a credit or financial institution, there can be no disbursement of the payment to natural persons that do not pass through the hands of participants in the clearing system that *are* such institutions and who will therefore carry out the necessary customer due diligence before passing the money further up the chain of entitlement. The suggested implementing law would therefore comply with the purpose set out in Article 11(1).

3.10 Given the size of the some of the payments which may be made in the bond market, and the relationship between transactions in this market and in other markets (most obviously, the derivatives market), any measures which might

have the effect of causing delay in the making of payments or introducing any uncertainty as to whether such payments may be made could clearly have very serious consequences, both for market participants in terms of the direct costs they might suffer and the impact in respect of their other obligations, and, more generally, for the effective operation of the markets. Further, "timely" payment is one of the key issues taken into account by the rating agencies when reviewing securities issues, and it is not inconceivable that measures which introduced a potential delay in payments in respect of issues structured using a trustee might result in such issues being given lower ratings, with associated cost and other implications for issuers. Against this background, care should be taken to ensure that measures which might affect the making of payments are only introduced if they are genuinely necessary to achieve the purpose of the Directive.

4 The Financial Markets – A broader exception

Where trustees are expressly appointed

4.1 In addition to bond issues, financial markets operations give rise to a number of other situations in which trustees are commonly appointed (see below Annex 1). Many of the features exhibited by these situations share features with the bond markets. To the extent that the situation is analogous, the impact of the Directive on those other markets is likely to be severely detrimental.

Where trusts arise by operation of the law

4.2 Much has already been said above, particularly in the context of Problem 2, about customer due diligence in the context of the intermediated securities markets. In practice, the provisions in the Directive may bring into question the operational feasibility of these markets in London. Ownership of investment securities is characteristically heavily intermediated through financial institutions acting as custodian as well as settlement systems, depositories and nominees, and this is conceptualised, in legal terms, as a “nest” of trusts with the custodians or intermediaries acting as trustees or sub-trustees and the investor holding a beneficial interest. In relation to pension funds and investment funds, the position is complicated further by the role of fund managers, who characteristically instruct custodians on behalf of their fund clients as agent, while disclosing but not naming their clients, which are identified by alphanumeric codes. It is not the practice for any intermediary to disclose the names of the investors on whose behalf it holds the shares or other investment securities, and it may be unable to do so as an operational matter. A legal measure which requires an intermediary higher up the chain to ascertain the beneficial ownership situation would be antithetical to the structural reality of the market in investment securities.

4.3 Equities are also held under an indirect holding system, like bonds. Thus the problems outlined in the previous sections for custodians and intermediaries are likely to have a similar impact in these markets. Equities markets, in addition to being heavily-intermediated, are also characterised by the participation of retail investment trusts and by the use of straight-through processing and outsourcing

to improve efficiency, both of which are, to some degree, incompatible with the due diligence requirements of the Directive.

4.4 On this basis, the FMLC would recommend a broader financial markets carve-out. The Committee is aware that this might appear to be contrary to the comprehensive policy on money laundering controls. However, as discussed above, particularly in relation to Problems 2 and 3, it may be that the policy requirement could alternatively be satisfied by money laundering checks applied by "Approved Clearing Systems".

4.5 It is our understanding, from correspondence with Euroclear on 18 December 2006, that the clearing systems' admission policies already involve money laundering vetting procedures. Euroclear Bank is required by Belgian law to verify the identity of its customers, including foreign undertakings, to FATF standards (see below, Annex 2). Checks are carried out not only upon admission, but also throughout the contractual relationship. Participants themselves are contractually required to comply with international customer identification standards. In the UK, CRESTCo follows FSA and JMLSG Money Laundering Rules as a matter of best practice and obliges its Sponsors, i.e. those sponsoring new members, to undertake anti-money laundering due diligence (see CREST Rules, paragraph 3.2).[7]

4.6 HM Government, in the light of this, may feel that it is prepared to relax controls which would, in practice, be at least partly duplicative.

5 Conclusion

The FMLC's conclusion is that the Directive presents several difficulties for trusts in issues of transferable and intermediated securities. Because trusts play such a pivotal role in the financial markets, in particular, in relation to bond issues, as well as to other commercial products, the FMLC is of the view that it is vital that the implementing legislation should provide for the solutions set out in this short paper.

[7] CREST Rules are available at http://www.crestco.co.uk/publications/reference/manual/rules.pdf.

ANNEX 1

CORE FINANCIAL TRANSACTIONS IN WHICH TRUSTEES ARE INVOLVED

CAPITAL MARKETS TRANSACTIONS

Transaction	Role of Trustee
Unsecured International Bond/Medium Term Note Programme	**Note Trustee** • holds the benefit of the payment obligation and other covenants on behalf of noteholders in parallel with the issuer's payment obligation to the noteholders • responsible for passive monitoring of compliance with issuer's obligations • has discretion to exercise powers on behalf of noteholders, including declaration of event of default, acceleration of notes, enforcement of noteholders' rights of recovery, agreeing waivers and amendments that are not prejudicial to noteholders, convening noteholder meetings and the substitution of obligors • acts in accordance with instructions of noteholders • noteholders may only enforce the note individually after trustee fails to do so
Sovereign Bonds	**Trustee** • as above • encourages use of collective action provisions (as recommended by the IMF)
Secured International Bond/Medium Term Note Programme	**Note Trustee** • as above **Security Trustee** • holds the benefit of security for the noteholders • enforces security following default and distributes proceeds to noteholders

	• acts in accordance with instructions of noteholders
Asset-Backed International Bond/Medium Term Note Programme/Commercial Paper Programme (including securitisations, repackagings and CDOs)	**Note Trustee** • as above **Security Trustee** • as above and in addition, may hold the security not only for noteholders but also for other secured parties, such as derivative counterparty, credit enhancement provider or liquidity provider • enforces security following default and distributes proceeds in accordance with priority of payments **Share Trustee** • holds the shares of the issuer-SPV on trust for secured creditors of the issuer-SPV • may be required to transfer the shares to beneficiaries or another trustee on occurrence of an enforcement event **Collateral Trustee** • holds the benefit of security granted by an SPV on trust for secured creditors of the SPV (possibly through other collateral trustees or the security trustee) • enforces security on behalf of secured creditors and distributes security in accordance with priority of payments • acts in accordance with instructions of secured creditors **Receivables Trustee/Master Trust Trustee** • underlying assets are transferred to the receivables trustee or master trust trustee for the benefit of the originator and the issuer-SPV (for the master trust, one of a number of SPVs covering different transactions), in varying proportions as the transaction progresses
Collective Investment Scheme (also known as Unit Trust)	**Trustee** • holds assets of the collective investment scheme for the benefit of investors, who have undivided participation of investment in the scheme • assets of the trust are invested by a manager in

	accordance with the trust deed • follows the instructions of the manager, e.g. with regard to voting of securities held by the trust • has a duty to take reasonable care to ensure that the manager calculates issue and redemption prices correctly
Debenture Stock	**Stockholder Trustee** • holds security on behalf of the stockholders • holds the benefit of payment obligations and other issuer covenants on behalf of stockholders • takes day-to-day decisions on behalf of stockholders in limited circumstances • enforces security following default and distributes proceeds to stockholders • acts in accordance with instructions of secured creditors
Mortgage Debenture Stock	**Stockholder Trustee** • as above, where the security includes mortgages • holds title deeds to unregistered mortgaged property • handles any releases and substitutions of property, based on valuation, title and security issues • acts in accordance with instructions of secured creditors
Participation Certificate	**Participation Trustee** • holds trust property on behalf of beneficiaries and distributes it in accordance with the terms of issue
International Equity	**Depositary Trustee** • holds underlying equity shares on trust for the investors • issues certificates (known as "global depositary receipts") to the investors, which are traded in the financial markets • passes through dividends to the investors and exercises voting rights on the underlying equity shares in accordance with investors' directions

High Yield bonds (trust documentation often contains additional covenants)	**Trustee** • generally takes a more active role than with investment grade bonds, due to the increased risk of default

TRUSTEE ROLES WITHIN MARKET INFRASTRUCTURE

Transaction	**Role of Trustee**
CREST – Crest Depositary Interests	• holds international securities under a Global Deed Poll for the benefit of holders in CREST of CDIs
CREST – cross-border securities settlement	• CREST (or another CSD) holds securities subject to transfer for benefit of seller and buyer during settlement process, to protect integrity of cross-border transactions.

BANK MARKETS TRANSACTIONS

Transaction	**Role of Trustee**
Secured syndicated loans	**Security trustee** • holds security over the assets of the debtor on behalf of the creditors • permits new syndicate members to participate in the lending and security without the need to re-charge the security
Project Finance	**Security Trustee** • holds security over a wide range of assets for the benefit of all the lenders, whose interests may vary • enforces covenants on behalf of the lenders **Trustee** • holds bank accounts into which project cashflows will be paid prior to their distribution

	• holds the benefit of covenants designed to protect the integrity of the security • responsible for monitoring the borrower's compliance with covenants • invests and directs cashflows as required by the parties and the project documentation
Private Finance Initiative	**Trustee** • is assignee of agreements which allow lenders time to arrange substitute providers of finance in the event of failure of particular aspects of financing arrangements

OTHER EXAMPLES OF COMMERCIAL TRUSTS

Transaction	**Role of Trustee**
Dual listed corporate structures	**Trustee** • holds special voting shares in both companies through SPVs • votes on joint electoral resolutions, thus ensuring that votes cast by both shareholders count in determining whether resolutions are passed • holds the benefit of warranties
Joint Ventures	**Trustee** • holds shares or voting rights in the company, thus providing greater protection for minority shareholders • acts as a controlling director of the company in cases where competition law or banking regulation may prohibit others from holding control
Intercreditor agreements	**Trustee** • a subordinated lender holds sums received via a subordination agreement on insolvency on trust for senior lenders • ensures that the position of the senior lender is protected,

	and not defeated by insolvency legislation
Custody arrangements	**Custodian** • places, maintains and safeguards the trust assets
Special voting shares	**Trustee** • holds and exercises rights of shareholders through a special voting company ensuring equality of benefits for shareholders
Holdings of golden/special shares	**Trustee** • holds and exercises rights of the shareholder in order to stream the benefits from its rights to different beneficiaries • can exercise negative control, as consent is required before specific changes are made to the ownership or structure of the company
Escrow Arrangements	**Security Trustee** • holds shares (in the seller) to the order of the purchaser against satisfaction of warranty claims
National and Euro Lottery	**Security Trustee** • holds funds on behalf of lottery winner

ANNEX 2

TO WHOM IT MAY CONCERN

Subject: Euroclear Bank SA/NV Anti-Money Laundering Program

Brussels, 4 September 2006

Pursuant to your query, I am pleased to provide you with the requested information.

The Euroclear compliance program first focus on the prevention of money laundering which could be resumed as follows:

1) The Belgian Banking, Finance and Insurance Commission (BFIC) regulates Euroclear Bank, as a Belgian credit institution, for money laundering prevention.

2) We are required to verify the identity our customers to FATF standards. It should be noted that the Directive 2001/97/EC of 4 December 2001 and the Belgian Act of 12 January 2004 amending the law of 1993 related to the prevention of the use of the financial system for purposes of money laundering were directly inspired by the text of the 40 Recommendations as elaborated by the FATF.

According to Belgian Act, a bank must identify its customers by means of probative documents and take copies of these evidential documents (i.e. a recent copy of the articles of association (by-laws) or equivalent documents, which must be translated if necessary; a copy of a recent publication in the *Moniteur Belge* (the official Belgian Gazette) or of any other recently issued document identifying the name, first name and address of the entity, and the person(s) authorised to engage it vis-à-vis credit institutions, which should be translated if necessary. With regard to foreign undertakings having an establishment in Belgium , it is required to submit an official document identifying the name, first name and address of the entity and the person(s) in charge of the management of the establishment in Belgium).

3) In order to meet the legal requirements in connection with the prevention of money laundering, Euroclear Bank has established a set of internal rules aimed at identifying and managing the risk of money laundering.

The aim is to provide a full identification of the clients, not only when they are admitted through the *Admission Policy*, but also for the whole duration of the contractual relationship with the bank, through the *Sponsorship Policy*. Another way to prevent the risk of money laundering is to make the employees aware of unusual and suspicious transactions.

Euroclear Bank observes precise criteria in order to meet the strictest international standards in terms of knowledge of the customer (*Know Your Customer Policies)*.
First of all, the Euroclear participants contractually undertake to make every possible efforts to combat money laundering and in particular to comply with the relevant international criteria and standards.
Moreover, Compliance has helped the departments concerned to refine the procedures for admission and control of our participants that already existed under JP Morgan.

The main rules laid down by Euroclear Bank in this connection are the following:

A. Admission Policy

This procedure constitutes the first line of defence against possible attempts at money laundering. All applications from candidates for admission as participants are passed on to the Admission Committee. The Committee takes its decision on the basis of five standard criteria: (i) the financial resources of the candidates, (ii) their technological capabilities, (iii) the necessities and motives for participating in the Euroclear system, (iv) their reputation on the market, and (v) a programme put in place to detect and punish money laundering.

The Admission Committee takes its decision on the acceptance of a prospective participant by a majority vote. If this decision is favourable, the file is sent on to the Management Committee of the bank, which is formally authorised to accept new participants.

The Client Service Administration group is obliged to ascertain that the documentation required for the admission of a new customer has been duly collected.

B. Sponsorship Policy

Every participant must be sponsored by a relationship manager (sponsor), an executive of the bank who ascertains that the participant complies on a continuous basis with the conditions defined in the admission policy. The sponsor must evaluate the reputation of the institution on the market and must be satisfied with the quality of the management and the experience of the participant. The sponsor keeps in regular contact with the participant and examines its annual accounts. All negative or unfavourable information about the participant must be communicated to Compliance and to the Management.

The procedures for the oversight of counterparties that have their registered office in one of the countries that are considered not to comply with the international standards on money laundering have been tightened. To this end, the sponsorship policy makes a distinction between participants from FATF approved countries, participants from FATF-blacklisted countries, and other participants. The last two categories of participants are now subject to stricter supervision.

The Sponsorship Policy provides for two levels of sponsorship according to the country where the candidate or participant is established, the nature of the contractual relationship between the bank and the counterparty (participant, local settlement and delivery system, *cash correspondent*, etc), the shareholders of the counterparty, or the fact of the bank having received a letter of reference from the parent company of the counterparty; this parent company must itself be established in a country that does not appear on the list of FATF-blacklisted countries and territories. If the bank does not have the aforementioned letter of reference, the sponsor will be asked to pay a visit to the participant or prospective participant in order to speed up the necessary investigations.

4) A special program runs regularly and screens the business activity of participants that meet certain criteria. Because of its specific role in the distribution of new issues, Euroclear has also established criteria to identify suspect new issues.
The unusual transactions will be reported to the Belgian authorities. The account managers have to produce and submit an Internal Report to Compliance whenever a suspicious transaction is identified.

Furthermore, we put in place specific monitoring procedures for the operations carried out by – or in favour of – customers established in countries whose anti-money-laundering legislation does not fully comply with international standards (the FATF blacklist).

In accordance with the Belgian legislation, Euroclear maintains enhanced effective controls designed to identify and investigate all suspect names and suspect behaviour. An automated tool (1) tracks all Participant transactions and internal Euroclear databases for suspect names against international and national watch lists and (2) monitors all Participant transactions for account unusualness and against money laundering and terrorist typologies. Unusual transactions and matching names are reported to the Belgian authorities.

Finally, we also scrupulously follow the list of countries for which the UN, the EU and the Belgian authorities put an embargo.

5) We are able to supply remitter’s details for payments delivered.
For payments instructions received by formatted Swift or Euclid 90, the remitter's details are automatically and routinely mentioned on our formatted Swift messages payments sent to the appropriate Correspondent or to the beneficiary's bank. It is the common practice for any intermediary Bank to mention all the details of the payment to allow the final Beneficiary to easily apply the incoming funds.
For payments received by Swift free format or by Telex, all details are manually introduced in the cash processing system and verified by a second person before the payments are released via formatted Swift messages.

In term of reporting to our clients, the details of the transaction are mentioned on both the electronic reporting (Swift MT 940 or R35) and the paper daily cash movement reporting.

For incoming funds, the details of the payment mentioned by the ordering party are transmitted to our clients on both the electronic reporting (Swift MT 910 or R 35) and the paper daily cash movement reporting.

6) Full records of the ordering customer and address are retained by us for a minimum of five years and made available upon request by an authorised authority.
As recommended by the Swift guidelines and imposed by some Real Time Gross Settlement cash systems (Target), all Financial Institutions having a Swift address are in principle identified on our formatted Swift payments by a BIC Code. The BIC Codes or Swift address are published in a Swift directory sent to the entire member Banks and allows a clear identification of the Banks.
For payments in favor of a corporation or an individual, we release to our Correspondent or the Beneficiary's Bank the information regarding the final beneficiary such as received from the ordering party.

7) As a Belgian financial institution, Euroclear Bank is required to ensure continuous awareness and adequate training of employees with regard to AML and STM obligations as well as to other compliance policies. Each new employee starting at a Euroclear group company follows a Newcomers training on Euroclear services and products within the first 30 days after his arrival. During this training, the new employee receives an introductory presentation on Anti-Money Laundering and Compliance related issues. The Compliance support team is responsible for this presentation on the Euroclear group's approach to compliance and the overall compliance attitude towards local and international legislation, regulations and business best practices.

Every two years, Euroclear Bank staff is required to take a 'refresher' training. The objective of this training is to remind Euroclear group staff of their responsibilities under the Compliance policies and to make them aware of new obligations or techniques in detecting and reporting money laundering and other suspicious activities. Euroclear Bank is obliged by regulatory requirements to assure that the level of knowledge and awareness of AML and related responsibilities reaches a sufficient level, in order for employees to handle in a correct manner when confronted with AML issues. To be able to assess such level, the compliance department has put together an mandatory "Compliance Quiz". This quiz consists of multiple-choice questions addressing specific issues such as Special Tax Mechanisms, Anti-Money Laundering, the Code of Ethics, the Gift Policy, General Compliance Procedures, Fraud Policy and Staff Dealing Policy.

Sincerely,
On behalf of Euroclear Bank SA/NV,

Emmanuel De Groote
Director
Compliance Officer
Euroclear SA/NV

c/o Bank of England
Threadneedle Street
London
EC2R 8AH

Telephone: (+44) (0)20 7601 3918
Fax: (+44) (0)20 7601 5226

Email: fmlc@bankofengland.co.uk
Website: www.fmlc.org

December 2006

COMMITTEE MEMBERS