

21 February 2020

Assets & Residence Policy Team
HM Revenue and Customs
Room 3C/03
100 Parliament Street
London
SW1A 2BQ



Dear Sir or Madam

Trust Registration and the Fifth Money Laundering Directive

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") 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.

In 2018, Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the "**Fifth Money Laundering Directive**" or "**5MLD**") came into force in the E.U. While certain sections of 5MLD have already been implemented in the U.K., changes required by 5MLD in respect of the registration of the beneficial ownership of trusts have not yet come into force. HM Treasury and HM Revenue and Customs are now jointly consulting on this aspect of the regime.¹ The Committee has commented in the past on aspects of the transposition of 5MLD in the U.K. and is grateful for the opportunity to draw some specific points to your attention.²

Trusts in financial markets

Questions 1 and 2 of the Consultation focus on the requirement in 5MLD that express trusts are registered. HM Treasury has provided exemptions from these requirements in relation to loans and bond transactions which the Committee welcomes. It urges HM Treasury to consider further exemptions in the clearing, securities settlement and payment systems space where express trusts are used as legitimate and efficient legal devices designed to reduce systemic and other risks. These so-called "financial markets trusts" are generally special purpose trusts which are used to enhance market confidence in trading, clearing, settlement and payments.

In the financial markets infrastructure ("FMI") context, there are three principal types of systemically-important arrangements that could potentially fall within the scope of the proposed registration requirement. It is unclear whether such trusts may be captured by the legislation. For clarity, the FMLC would recommend that bespoke exemptions are drafted for the following types of trusts given their systemic importance.

1. *Trusts created for the purpose of managing systemic and other risks in the FMI context:* Designated systems under the Settlement Finality Regulations 1999 (the "**SFR**") use express trusts as part of their "default arrangements"—i.e. the trusts operate as part of arrangements put in place by operators of designated systems for the purpose of limiting systemic and other risks which arise in the event of a participant appearing to be unable, or likely to become unable, to meet its obligations as a participant (e.g. in the event of its insolvency). These arrangements are constituted as express, bare trusts over cash and are designed to ensure the completion of settlement in the event of insolvency. They have

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been particularly instrumental in supporting non-bank payment service provider access to payment systems, while safeguarding client monies and minimising credit, liquidity and other risks for the U.K.'s financial system.³

2. *Bank of England as "security trustee"*: The Bank of England acts as security trustee for charges granted by participants in designated payment systems over their reserve collateralisation accounts and/or settlement collateralisation accounts held by it (as settlement agent for the relevant payment systems). These arrangements also operate as part of the "default arrangements" of these systems, but here the subject matter of the bare trust is not cash itself, but the charge granted over a cash balance held with the Bank. It is uncertain whether these arrangements could also fall within the Bank "as monetary authority" exemption which is currently proposed in the Consultation.
3. *Trusts in support of FMI settlement and accounting arrangements*: A subsidiary of Euroclear UK & Ireland Limited ("EUI"), the U.K.'s central securities depository ("CSD"), issues "CREST depository interests" ("CDIs") under a trust deed poll in favour of CREST members who hold, from time to time, uncertificated units of the CDIs on the relevant Operator register of securities maintained and updated by EUI pursuant to its statutory obligations under the Uncertificated Securities Regulations 2001 ("USRs"). CDIs are English law governed securities issued in the form of dematerialised depository receipts which are cleared and settled through CREST and which represent interests in underlying overseas securities. In this way, the trust arrangements for CDIs play an important role in the wider financial markets by facilitating the safe and efficient settlement of transactions in overseas securities under so-called "link" arrangements put in place between EUI and a Third Country CSD.⁴

The FMLC considers that the first two categories of trust described above should not fall within the proposed trust registration requirements because, first, their purpose is the management of systemic risk and, second, the Bank of England (as designating authority) is already required to assess whether the trust arrangements (as part of the system's default arrangements) are "appropriate for the system in all the circumstances".⁵ The purposive, transparent and evaluative processes inherent in these procedures make the proposed legislative requirement for registration inappropriate for the relevant trust arrangements.

Equally, in respect of the third point, above, the relevant particulars of the holder of each unit of a CDI, as beneficiaries under the trust constituting the securities, are entered into and maintained on the relevant Operator register of securities maintained by EUI (which is supervised by the Bank of England) under statutory obligations. The terms of the trust deed poll are published in the publicly available "CREST International Manual".⁶ It would arguably be duplicative and unduly costly to require an additional registration of the CDI trust.

Exemptions for these FMI trusts from the trust registration requirements could be addressed by a suitably targeted systemic protection/financial markets infrastructure exemption (for example, by reference to designated systems' "default arrangements" under the SFRs). For other "financial market trusts" like the CDI trust arrangements, an exemption could be created to cover all trusts where particulars (e.g. names and addresses) of the holders of the beneficial interests under the trusts are entered up on any register of securities and/or record of securities which satisfies specific conditions that may assuage any concerns about money laundering.⁷

These points are part of a wider issue concerning the ubiquity of trusts in financial markets arrangements which is a unique feature of Common Law jurisdictions. The FMLC would urge HM Treasury to deliberate on the onerous nature of the proposed requirements to register trusts, especially in the context of the need for proportionality. This issue might be exacerbated by the absence of a statutory definition of, or guidance in relation to, “express trusts” which may result in an inflation in the types of trust captured by the regime.⁸ For example, despite the exemption provided by HM Treasury to the registration requirement for trusts arising in relation to bond issuances, the drafting of that exemption does not accommodate other types of trusts which might arise in relation to a capital markets transaction. Thus, in relation to a securitisation transaction, there may be a bond trust, a security trust, a share trust, a collection account trust and turnover trusts. In relation to trusts set up for loan purposes, it is unclear whether beneficiaries must be identified on an ongoing basis. The registration requirement could prove to be disproportionately burdensome for a number of U.K. trusts, particularly those that are used widely in the financial markets, such as those for the custody of intangible assets, escrow accounts, guarantees in transaction documents, and credit facilities made available by an authorised person in the U.K.

Legal Entity Identifier

Although the Consultation does not specifically address the question of legal entity identifiers (“LEIs”), the Committee would like briefly to bring to HM Treasury’s attention the importance of LEIs in the context of the expansion of the anti-money laundering regulatory regime to cover virtual currencies. Following the 2008 financial crisis, authorities and the private sector cooperated to develop the framework of a Global LEI System that will, through the issuance of unique LEIs, unambiguously identify legal entities engaged in financial transactions.

5MLD and its implementing legislation in the U.K. introduce disclosure obligations for cryptoasset exchange providers and custodian wallet providers. The FMLC understands that organisations more involved in the creation and promulgation of LEIs have corresponded with HM Treasury on this issue and wishes to add its voice to the support for the adoption of LEIs.⁹ The use of LEIs as part of disclosure requirements for firms offering cryptoasset exchange services and custodian wallet service providers as this could contribute significantly to the transparency in this unregulated capital market. This is especially true in the context of initial coin offerings which are not yet typically accompanied by standardised documentation, leading to the establishment of information intermediaries. A requirement to utilise LEIs would help investors identify token issuers without the need for intermediaries, therefore protecting against fraud.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,



Joanna Perkins
FMLC Chief Executive¹⁰

¹ HM Treasury and HM Revenue and Customs, *Fifth Money Laundering Directive and Trust Registration Service: Technical Consultation Document*, (24 January 2020), available at: <https://www.gov.uk/government/consultations/technical-consultation-fifth-money-laundering-directive-and-trust-registration-service>.

² The FMLC's response from August 2019 is enclosed with this letter as Appendix I.

³ Trusts have also been used as part of the "default rules" of central counterparties ("CCPs"), including those rules supporting the "porting" of assets and positions under Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ("EMIR") and central securities depositories ("CSDs") under Part 7 of the Companies Act 1989 to manage the risks associated with participant defaults.

⁴ In addition, under Article 39 of EMIR and Article 38 of the Central Securities Depositories Regulation 2014 ("CSDR"), CCPs and CSDs are required to keep and make available accounting arrangements that allow for the segregation of (a) their own assets from the assets of their clearing members and participants, and (b) the assets of individual clearing members, or participants, from the assets of other clearing members or participants. Those Articles contain similar segregation requirements on the clearing members and participants themselves.

⁵ See regulations 4(1) and 7 of the SFRs, with reference to paragraph 6 of the Schedule to the SFRs. Similar assessments are made with respect to the default rules of CCPs and CSDs by the Bank of England (or the relevant EU competent authority) as the relevant supervisory authority for these types of FMI under EMIR and the CSDR respectively.

⁶ With regard to the accounting requirements of Article 39 of EMIR and Article 38 of the CSDR, it is widely recognised that, in practice, trust arrangements will (under English law) be required to enable the CCP, its clearing members, the CSD and its participants, to ensure compliance with the relevant accounting requirements.

⁷ These conditions might include the following:

1. the relevant register or record is required by any enactment or instrument to be maintained in the United Kingdom; and
2. that register or record is required by any enactment or instrument:
 - a) to be made available to inspection; and/or
 - b) to record the names and addresses of all persons holding the relevant securities from time to time.

⁸ Trusts are not easily understood by lay persons and even some non-trust lawyers would need to research what is meant by express trust in order to understand which trusts are in scope. Accordingly, we think it is imperative that any guidance published by HMRC should set out a clear definition of what is meant by express trust. On a fundamental level, people need to understand whether or not their trust is an express trust in order to determine whether it needs to be registered. This point is emphasised in a foreign law context when trying to determine whether a type A or type B trust exists, which involves ascertaining whether a trust is an express trust. To undertake this analysis in respect of legal arrangements which may not have the nomenclature "trust", it is essential to have a clear definition of express trust to apply to a particular arrangement.

⁹ Global Legal Entity Identifier Foundation, *Response to HM Treasury on the Transposition of the Fifth Money Laundering Directive Consultation*, (June 2019), available at: https://www.gleif.org/content/1-about/8-consultation-responses/2019-17-06_gleif-response-hm-treasury-aml-directive-consultation-web-publication_v1.0-final.pdf.

¹⁰ The FMLC is grateful to Kate Gibbons (Clifford Chance LLP) and Natalie Lewis (Travers Smith LPP) for their assistance in drafting and reviewing this response.

FMLC Research Manager

From: FMLC Research Manager
Sent: 09 October 2019 15:27
To: Anti-MoneyLaunderingBranch@hmtreasury.gov.uk
Subject: Transposition of the Fifth Money Laundering Directive

Dear Sir or Madam,

By way of introduction, I am the Research Manager at the Financial Markets Law Committee (“FMLC”). The FMLC is a charitable think-tank established by the Bank of England and devoted to legal education, the better administration of the law and the contribution these objectives can make to market stability and continuity.

On 30 July 2019, the FMLC submitted a [response](#) to HM Treasury’s Consultation on the transposition of Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the “**Fifth Money Laundering Directive**” or “**5MLD**”) in the U.K. That response concerned the definition of virtual currencies in 5MLD.

The Committee also wished to express certain observations which are aligned with submissions it understands have been made by other interested parties highlighting concerns about the impact of the extension of the scope of the regime to apply to all express trusts, new and pre-existing, not just those that have tax consequences. The FMLC published a [paper](#) in 2006 which highlighted a number of issues in respect of the transposition of Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (the “Third Anti-Money Laundering Directive”). Many of the issues raised in that paper are pertinent to 5MLD, in particular the comments in Section 4 regarding the use of trust structures generally in the financial markets.

I have set out below my signature brief descriptions of the issues arising in this context.

I do apologise that the FMLC was unable to send this letter to you before the Consultation deadline. Thank you for your consideration now.

If I can provide any further information, please do not hesitate to get in touch.

Best wishes,

Venessa



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Uncertainties arising owing to the extension of the scope of the regime to apply to all express trusts

- a) Since trusts are employed so extensively under English law for arrangements that would be contractual in other jurisdictions, the provisions could have a disproportionate impact on the UK and as a consequence, inconsistent application across the EU. There are a number of examples of trust structures set out in Annex 1 of the FMLC’s 2006 paper, including syndicated loan agreements with guarantor provisions and/or turnover arrangements. The registration obligation is not confined to express trusts created after the regime comes into effect, or to clearly specified categories of trust. This produces a

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significant compliance burden on businesses and individuals which is potentially disproportionate and unfeasibly onerous.

- b) Clarification of the meaning of “individuals” in the definition of “beneficial owner” for the purpose of trust record keeping and registration. It is unclear whether the definition refers only to “natural persons” or also includes “legal persons”. To promote a consistent approach, this should refer only to beneficial owners who are natural persons, reflecting the approach taken in other EU Member States.
- c) Chapter 2 (*New obliged entities*). It is unclear which advisers the expanded category of “tax advisor” is intended to cover, which could impose a significant additional regulatory burden on those who have to determine whether this requirement will apply to them.
- d) Chapter 4 (*Customer due diligence*). The potential impact of the new mandatory verification requirements and their interpretation could make on-boarding processes difficult to satisfy and lead to differences in approach or even a mechanical approach to due diligence.
- e) Chapter 5 (*Obligated entities: beneficial ownership requirements*). Further clarity is needed regarding the relevant trigger events for the review of beneficial ownership information.
- f) Chapter 6 (*Enhanced due diligence*). Moving from a risk-based system to more mandatory requirements will impose an additional burden and in particular the requirement to conduct EDD in respect of transactions “involving” high-risk countries is open to broad interpretation and could lead to inconsistent approaches. The requirement to apply EDD on “complex” transactions per se is new and would capture many transactions which do not necessarily present a higher risk of money laundering or terrorist financing, but are by their nature complex.
- g) Chapter 8 (*Mechanisms to report discrepancies in beneficial ownership information*). The interaction between information held on the People with Significant Control (PSC) register and beneficial ownership information acquired during customer due diligence is not clear. These are different legal regimes with different tests (the test for “control” is not the same as that for “beneficial owner”) and therefore the reporting of “discrepancies” between the two records may result in unnecessary reports being made. This imposes a potentially substantial burden on obliged entities and would additionally require Companies House to investigate numerous misleading reports.