

## NOTE ON ANTI-MONEY LAUNDERING ("AML") IN THE STRUCTURED FINANCE SECTOR IN IRELAND

### 1. Overview of structured finance sector in Ireland

Special Purpose Vehicles (SPVs), securitisation and structured finance arrangements are a fundamental part of the international financial services infrastructure. In addition to being an important financing channel, SPVs and securitisation are required and used by a cross-section of the international financial services sector; investment funds, the aircraft leasing sector and insurance companies to hold certain types of eligible assets, as part of their risk management strategies. With an infrastructure of specialist service providers, including directors, advisers, and trustees, Ireland is the leading European jurisdiction for SPVs and securitisation and the industry in Ireland has supported and serviced the widest range of structured finance deals.

### 2. Typical deal structure<sup>1</sup>

The graphic below illustrates the typical payment flows and contractual relationships in a structured finance deal, the key features of which are as follows:

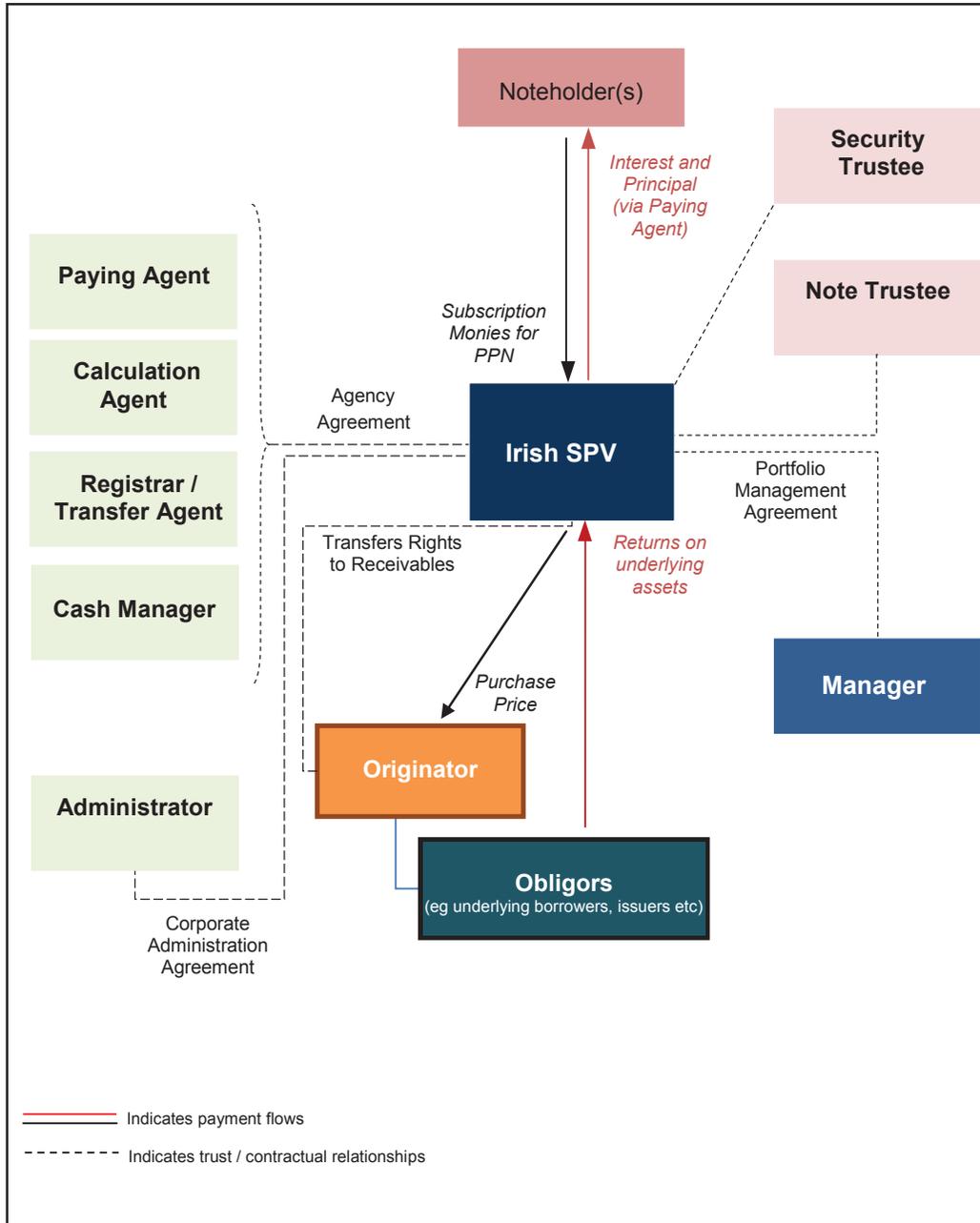
- (a) A special purpose vehicle ("**SPV**") is established to raise funds by issuing debt securities (typically bonds) to investors (the "**Noteholders**").
- (b) The proceeds of the securities issued (i.e. the subscription monies) are used by the SPV to purchase receivables or other assets. These are rights in respect of financial obligations arising from the obligation of a debtor (the "**Obligors**") to pay his creditor amounts in respect of a debt. Receivables may arise from payments owed on loans, monies owed for the purchase of goods or services, or any other circumstance creating a financial obligation.
- (c) Before their sale to the SPV, the receivables are generated and/or owned by an established business entity (typically a financial institution or large company) (the "**Originator**").
- (d) The SPV's obligations to the Noteholders are limited to and secured by a security interest created by the SPV over the receivables purchased by the SPV from the Originator.
- (e) When amounts payable in respect of the receivables are received by the SPV, they are used to fund the payment obligations of the SPV under the issued securities, and to meet other fees, costs and expenses owed by the SPV to various service providers.
- (f) Outside of the primary participants, there will typically be a number of service providers supporting the deal structure including:
  - the paying agent who will distribute amounts owed by the SPV to the various parties involved according to the priority set out in the cash flow waterfall;
  - the corporate service provider who provides local corporate services including maintenance of statutory records, preparation of management accounts and annual audited financial statements; and

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<sup>1</sup> There are other types of structure but this one is a representative example for the purposes of this exercise.

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- the manager (often FCA or SEC-authorized) who will manage the SPV's portfolio of receivables/assets.



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### **3. Money laundering and terrorist financing risks**

The key money laundering and terrorist financing risks in a structured finance deal are that the investors will purchase the debt securities from the SPV using criminal proceeds ("**investor risk**") or the Obligor will use criminal proceeds to finance repayments to the SPV ("**Obligor risk**").

### **4. Mitigation of money laundering and terrorist financing risks**

#### (a) Investor risk

Transactions in the European securitisation markets are not conducted in cash. All subscriptions and transfers are carried out electronically through regulated banking systems where the appropriate AML checks and monitoring are undertaken by the regulated bank at the point of entry to the banking system.

In many cases, the arranger of the deal and/or the asset manager will carry out AML checks on the investors, in line with investor legal form and risk rating as these investors would have been introduced to the deal by the arranger and/or asset manager and would be treated as customers of the arranger and/or asset manager.

The majority of bonds issued in Europe are issued in global bearer bond format and are held and transferred electronically through the major European clearing systems such as Euroclear (in Belgium) and Clearstream (in Luxembourg), amongst others. The SPV issuers of such bonds do not have access to the information regarding the identity of the holders of their bonds. This information is held in a confidential manner by the clearing systems. AML checks are carried out within the clearing system by Euroclear/Clearstream on the account holders (e.g. where a custodian is holding the bond for an investor) and by the account holders themselves on the investors.

Where bonds are not held in global bearer bond format and transferred electronically through the major European clearing systems, they are usually issued in registered form. However, the bonds are freely transferable and the consent of the SPV is not required prior to the transfer of such bonds which means that there is no opportunity for the SPV to apply AML checks to the acquirer of such bonds.

#### (b) Obligor risk

In circumstances where the assets/receivables are acquired from a regulated Originator, in order for the Originator to comply with its own regulatory requirements the Obligor should in all instances be subjected to appropriate AML checks when originally becoming a customer of the Originator. In addition, certain SPV's will conduct full CDD checks on Obligors on a best practice basis when acquiring the assets/receivables from the Originator.

### **5. Applicability of Irish AML legislation to structured finance sector in Ireland**

The relevant legislation in Ireland applicable to AML is the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, as amended ("**CJA**"). The CJA applies to "designated persons" as defined.

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It is worth noting that, subject to a number of limited exceptions, SPV's are generally not within scope of the CJA, and as such, are not required to carry out any AML checks in respect of their investors or the underlying assets which they acquire.

The definition of "designated persons" is lengthy and includes financial institutions. There is a further definition of a financial institution which includes several entity types. The only entity types that would appear to be relevant to SPVs would be financial entities that carry on the following activities: -

*"2. Lending including, inter alia: consumer credit, mortgage credit, factoring, with or without recourse, financing of commercial transactions (including forfeiting)."*

*"3. Financial leasing."*

In general, SPVs would not carry on a business of lending as referred to at 2. above or a business of financial leasing as referred to at 3. above . However, in a small number of cases an SPV may do so. In such cases, the SPV may need to comply with the CJA and this will typically be achieved through the appointment of a regulated administrator, manager, trust or corporate services provider or credit servicing firm who will conduct the necessary CDD checks on behalf of the SPV.

Regardless of an SPV's status as a designated person, the transposition of the 4th Anti-Money Laundering Directive will introduce greater transparency in relation to an SPV's beneficial ownership through the creation of an obligation on the SPV to hold such details and report it to a central beneficial ownership register.

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