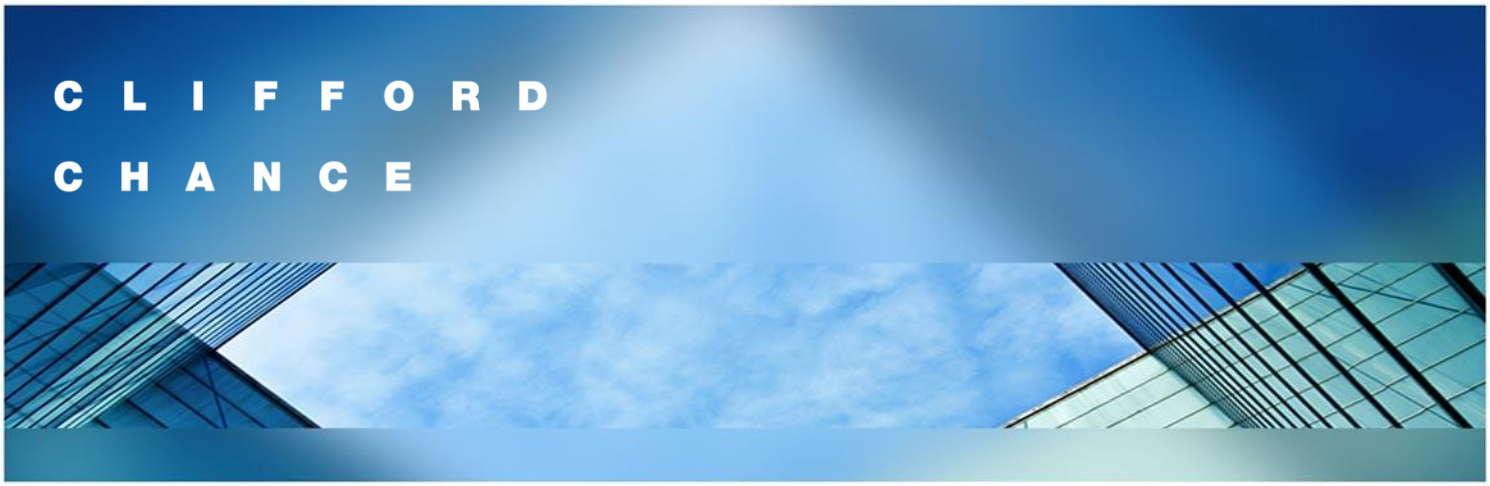

AMLD5: EXPANSION OF THE UK TRUST REGISTRATION SERVICE – IMPLICATIONS OF THE DRAFT REGULATIONS FOR UK BUSINESS

On 24 January 2020, HM Revenue and Customs (**HMRC**) and HM Treasury (**HMT**) published the anticipated technical consultation on the expansion of the trust registration service to cover all express trusts in order to implement the EU Fifth Anti-Money Laundering Directive (**AMLD5**). Appended to the consultation document are the proposed draft regulations for the expanded registration requirement. The technical consultation promises a proportionate approach by government to the registration requirement and an intention to keep out of scope trusts which present a low risk of being manipulated for money laundering and terrorist financing purposes (**low AML risk**). However, the draft regulations do not fully realise this ambition. Given the ubiquity of trusts in English law, this risks creating considerable commercial disruption and even undermining the purpose of the regulations. Clifford Chance has therefore submitted a response to the consultation informed by our practical experience of trusts across a wide range of commercial transactions. We highlight below some of the key themes in our response.

Key issues

- A proportionate approach and consistent implementation with EU Member States is critical
- Additional exemptions are required for trusts with low AML risk (e.g. trusts used in custody arrangements)
- The exemptions should apply equally to Type A Trusts and Type B Trusts
- Grandfathering is required in respect of historic trusts which, in many cases, can span decades
- Beneficiaries of a trust should be registered as a class where they change frequently
- The penalty regime should be civil not criminal

EU MEMBER STATES

The preponderance of trusts in English law contrasts starkly with the rarity of trusts in EU Member States (e.g. German law does not permit their creation). It is a unique feature of English law that many legal arrangements, which would be contractual under the laws of other jurisdictions, take the form of trusts. The government has previously noted the need to ensure that AMLD5 is implemented consistently across the UK and EU Member States. This echoes AMLD5 which stresses the need for a proportionate approach. To treat the same legal arrangements differently across the UK and EU Member States risks level playing field issues, with the UK at a disadvantage.

Ensuring that the UK takes a proportionate approach to implementation of the registration requirement also becomes difficult in the absence of a basis of comparison. Many EU Member States have not yet implemented the registration requirement, while implementation is underway by other EU Member States. A good argument can therefore be made for the government to hold off finalising the draft regulations until there is visibility on how a reasonable number of EU Member States have implemented the registration requirement.

THE DRAFTING APPROACH

The draft regulations apply the registration requirement broadly to all express trusts then provide for exemptions for trusts which HMRC/HMT consider low AML risk. The consequence of this drafting approach when applied to trusts is that there are inevitably omissions because of the ubiquity of trusts in English law across all areas of commercial and personal life.

In our response, we therefore suggested additional exemptions in respect of certain trusts that are low AML risk, or are supervised elsewhere, together with proposed drafting. We also highlighted where there were limitations in the existing exemptions and proposed drafting to make them more comprehensive, reflecting fully the principles informing them.

ADDITIONAL EXEMPTIONS

The additional exemptions we suggested relate to a broad spectrum of areas including real estate, corporate, intellectual property, oil and gas, asset finance, financial regulation and solicitors holding client money. In each case, the trusts we identified present a low AML risk, or are supervised elsewhere, making it disproportionate, given the associated costs, time and bureaucracy, to require their registration. It is also important for the government to retain flexibility to add further exemptions as the need for them is identified, in order to avoid unintended consequences and potential distortions of the UK financial system and other markets.

A key financial exemption we suggested relates to custody of intangible assets such as dematerialised securities, where English case law demonstrates that a custodian of dematerialised securities will be regarded as holding those securities on trust. We highlighted the practical necessity of a trust structure to safeguard a client's ownership rights in the event of a custodian's insolvency, as required under the Client Assets Sourcebook of the FCA handbook. Given the scale of the UK custody industry, having to register all custody clients would be extremely onerous and potentially give rise to client confidentiality issues. It would also be disproportionate; as a regulated activity under FSMA, custody presents low AML risk. Without an exemption, there is a risk of market distortion and level playing field issues in relation to cross-border custody relationships as various jurisdictions do not characterise custody as giving rise to a trust relationship; whether there would be a registrable trust would therefore depend on the characterisation of custody in the relevant jurisdiction. Application of the trust registration requirement to custody relationships could also make the UK a less attractive jurisdiction in which to invest or do business from the perspective of non-UK funds and institutional investors.

Other examples of exemptions we suggested include trusts incidental to a transaction (e.g. transaction documents which provide for a party to hold on trust any money or assets it receives in a manner not contemplated by those documents pending payment to the correct recipient); trusts dealing with the registration gap when title to certificated shares in a UK company or UK registered land is transferred; rent deposits and service charge payments held

on trust for tenants and trusts arising where monies are held in solicitors' client accounts or under escrow arrangements.

LIMITATIONS IN EXISTING EXEMPTIONS

Two exemptions which are particularly welcomed are in respect of certain credit facilities and bond issuances. They are couched around the involvement of an authorised person (defined as a person authorised under FSMA) in the relevant transaction (e.g. trusts in relation to credit facilities advanced by an authorised person are exempt).

In our response, we highlighted that this could give rise to arbitrary and unintended results. For example, credit facilities advanced by UK banks would be exempt, whereas the same facilities advanced by non-authorised persons (e.g. funds) would not be exempt. We therefore suggested more comprehensive drafting which reflects the spirit of the exemptions (the low AML risk presented by the wholesale financial and capital markets), but remains faithful to the objectives behind the money laundering legislation.

TYPE B TRUSTS

The draft regulations distinguish between UK trusts (**type A trusts**) and non-UK trusts (**type B trusts**), with the exemptions applying to the former only. In our response, we noted that there was no basis for this distinction, it could be arbitrary in practice and lead to some illogical results or unintended consequences, such as discouraging non-UK trusts from doing business with UK AML regulated service providers (e.g. UK financial institutions) to avoid registration.

For example, in the case of a bond issuance, if the bond trustee was an authorised person, the trust would be a type A trust. Whereas, if the bond trustee was a non-UK person (which enters into a business relationship in the UK in its capacity as trustee), the trust would be a type B trust and registrable. Accordingly, to avoid any unintended consequences and the potential for forum shopping, we suggested that the exemptions apply equally to type A trusts and type B trusts.

GRANDFATHERING

The draft regulations do not contemplate grandfathering of the registration requirement. Given the omnipresence of trusts across all aspects of personal and commercial life, many of which may also span decades, this presents an extremely difficult and, in many cases, impossible diligence exercise. For example, real estate is frequently held as a long term income generating asset so trusts relating to it may have been created decades ago and, in a structured debt context, it is not uncommon for some notes to have maturities of forty years or more.

The costs and time involved in attempting to identify historic trusts could be astronomical. Where there is low AML risk, it would also be extremely disproportionate and produce no real benefit. The trustee may also have no means to compel the beneficiaries of a trust to provide the requisite information. In our view, this necessitates a cut-off date for historic trusts.

CLASS OF BENEFICIARIES

In many finance and capital markets transactions, the class of beneficiaries under the related trusts may change frequently (e.g. lenders benefitting under a security trust). Requiring registration of each beneficiary of such a trust would therefore be extremely onerous and disproportionate given the low AML risk. Accordingly, should the exemptions referred to above not apply to a given

transaction, the beneficiaries should be registered as a class (e.g. bondholders).

PENALTIES

The government has proposed a new penalty regime in respect of the expanded registration requirement. Informing the new regime is a commitment by the government to take a proportionate approach, recognising that many lay trustees may not be aware of their obligations. While this approach is to be welcomed given the complexity of the registration requirement and prevalence of trusts across all aspects of life, we requested clarification that the new offences of failure to register on time and failure to keep the record up-to-date, which are administrative offences, would not be criminal in nature. Having a civil regime would be more measured and avoid trustees unwittingly committing a criminal offence.

NEXT STEPS

With the consultation closed, the government's response and final regulations are awaited. In the consultation document, the government anticipated a registration deadline of 10 March 2022 for existing trusts, so time is of the essence for the final regulations to be published to enable in scope trusts to be identified and the requisite steps undertaken in preparation for their registration.

We are aware that many Trade Associations and other industry bodies have also responded to the consultation, making many of the same comments. It therefore remains to be seen the extent to which the final regulations will be shaped by all the responses and whether the regulations will live up to the government's stated intentions of proportionality, alignment with EU Member States and targeted implementation.

If you would like to discuss how the new rules may impact your business, please get in touch with your usual Clifford Chance contact or any individuals listed in this briefing.

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