12: Asset finance

Note: This sectoral guidance should be read in conjunction with the main guidance set out in Part I of the Guidance and, where relevant, the guidance in Part II Section 11: Motor Finance.

Purpose of the Sectoral Guidance

12.1 When carrying out CDD measures, providers of asset finance should follow the customer due diligence guidance set out in Part 1. The purpose of this sectoral guidance is to draw attention to the AM /CTF risks attached to the activity of providing asset finance, and to assist providers in making their own risk assessments of their activities, as required by Regulation 18.

What is Asset Finance?

12.2 Asset Finance is a broad term referring to the financing of 'fixed assets'; they are typically tangible, such as equipment, transport vehicles, and plant and machinery, but not always (e.g. software). Assets can range from the very expensive, such as trains, ships, aeroplanes and oil rigs; through a mid-range such as plant and machinery, industrial installations and large IT projects; to low-value assets such as smaller IT and office equipment, cars and commercial vehicles.

12.3 Asset Finance customers (sometimes called 'End Users') can be businesses (in the form of legal persons or natural persons); public sector entities; and not for profit entities.

12.4 Household goods (home media and computing; 'white goods'; furniture) do not generally fall into the Asset Finance definition, even though they are assets. Rather they would come under the umbrella of Consumer Finance, unless being acquired by a commercial enterprise for commercial purposes, when these assets would fall into the definition of Asset Finance.

12.5 Consumers (Non-Business) financing their cars would typically come under the umbrella of Motor Finance (see Section 11).

Financial Products

12.6 A variety of financial instruments are used to finance assets:

(a) Lease:

There are essentially two forms of lease (both identical from a legal perspective):

Finance Lease: the lessor purchases the asset, and the minimum contractual repayments recoup most (and generally all) of the capital cost of the goods for the lessor.

Operating Lease: the lessor purchases the asset, and the minimum contractual repayments recoup materially less than the capital cost of the asset for the lessor. A common form of operating lease is 'contract hire', which gives the customer the use of the asset, together with additional services such as maintenance and replacement of worn parts. Cars, commercial vehicles, forklift trucks and aeroplanes are often financed this way.

[N.B. Operating Leases fall outside the scope of the Money Laundering Regulations.]

During the life of the contract, ownership of the asset resides with the lessor. At the end of the lease, legal title to the asset cannot pass directly from lessor to lessee, but in the case of finance leases the lessor will typically relinquish its own interest in the asset, or make arrangement for title to pass to the lessee via a third party.

(b) Hire Purchase:

The Hiror purchases the asset, and the contractual repayments due from the Hirer recoup the full cost of the asset for the Hiror.

During the life of the contract, ownership of the asset resides with the Hiror. At the end of the contract, the Hirer has an Option to Purchase the asset for a nominal sum, which the Hiror fully expects the Hirer to exercise (and it would be highly unusual for the Hirer not to exercise such Option).

(c) Conditional Sale:

The lender purchases the asset, and the contractual repayments recoup the full cost of the asset for the lender.

During the life of the contract, ownership of the asset resides with the lender, but at the end of the contract legal title in the asset automatically passes to the customer.

(d) Credit Sale:

The lender purchases the asset, and the contractual repayments recoup the full cost of the asset for the lender.

On day one of the contract, legal ownership of the asset passes to the customer.

(e) Loan:

The lender does not purchase the asset, but advances a sum of money to the customer (or sometimes to the vendor of the asset on behalf of the customer) for the customer to do so. The customer therefore takes legal title to the goods directly from the vendor.

The contractual repayments recoup the full loan advance for the lender.

12.7 The contracts for the financial instruments may contain ancillary features, such as the provision of services, or provision for extension or early termination, but the basic legal characteristics should not change.

Providers of Asset Finance

12.8 Except where the finance transactions are regulated by the Consumer Credit Act 1974, entering into asset finance contracts as principal is not a ‘regulated activity’ under the FSMA (Regulated Activities) Order 2001.

12.9 Asset finance can therefore, be provided by a range of commercial entities:

- Banks and Credit Institutions
- Manufacturers of assets
- Independent vendors / dealers of assets
- Commercial Finance Brokers

The Money Laundering Risks in Asset Finance

12.10 The general money-laundering risks associated with customers are described in Part I and Part I.

12.11 The various specific features of Asset Finance can increase or decrease the risk of money-laundering/terrorist financing, and the key features are considered below:

- Repaying borrowed money over time, or paying lease rentals over a medium-term period, provides a very slow means of 'layering' the proceeds of crime. *Lower Risk.*

- The amount of credit obtainable is generally limited by the strength of the financial statements of the customer. In other words, layering a lot of money would only be possible for a financially strong business (which by implication would be registered for VAT, would undergo some accounting inspection, even if not subject to audit, etc). *Lower Risk.*

- Customer has to acquire a 'business asset';

    - many business assets have little or no resale value, so present a poor opportunity for being realised for cash, even allowing for the 'costs' that money-launderers are prepared to tolerate. Industry jargon sometimes refers to such assets as 'soft assets', despite them often being 'tangible'. *Low Risk.*

    - Certain assets do have reliable resale values, and such assets should attract a greater CDD risk-score. Industry jargon sometimes refers to these as 'hard assets'. *Medium Risk.*

    - Luxury assets may be desirable to criminals in their own right (e.g. expensive cars); these should attract the highest CDD risk score. *Higher Risk.*

- The monies used to purchase the assets:

    - Are generally paid directly to supplier of the assets. *Low Risk.*
    - Are sometimes paid to the customer. *Medium Risk, unless subsequent payment to the supplier is verified, in which case Low Risk.*

- Payment of Finance Agreement instalments:

    - by the customer via direct debit from a UK bank account. *Low Risk.*
    - By cash. Should be closely investigated and understood. The source of the funds in such instances should be clearly established. *High Risk.*

- Overpayments should only be reimbursed to the customer named on the agreement. Any requirement to pay over monies to 'unrelated third parties' should attract consideration as potentially suspicious. *High Risk.*

12.12 Providers of Asset Finance should make specific risk assessment of the following:

- The suitability of the asset for the customer. Does it make sense for this customer to want to acquire that asset?

- The bona fides of the Vendor of the asset.

    - Is it a properly established business?
    - Does its location make sense given the customer's location?
    - Is the business related in any way to the Customer (e.g. common directors, same address, etc.)? If 'yes', then asset-sale-purchase may not be genuine, in which case:

        - potential ‘fund-raising’
        - possible money-laundering ‘fraud’.

- In the case of ‘Sale and Leaseback’, the Asset Finance provider should obtain the original underlying invoices from bona fide suppliers to customer, and confirm that the invoices have been paid by customer. Asset Finance provider should mark the original invoices as being financed by them, before returning them to the customer. This process helps assure the bona fides of the transaction, and avoids ‘double financing’ and handling the proceeds of crime.

12.13 Early termination of a finance agreement (i.e. just after its inception) presents the greatest opportunity for laundering money to money-launderers. Many early terminations (and notably ‘upgrades’) make commercial sense, but those that appear like a *cash purchase dressed-up as a short-term finance agreement* could be ‘layering’ and could provoke suspicion of money-laundering.

12.14 Loans, depending on how they are processed, may pose lower or higher risk of money laundering or terrorist financing:

- Where the lender pays the loan advance to a bona fide supplier in settlement of a bona fide invoice addressed to Customer, the financial instrument presents a lower risk;
- Where the lender pays the loan advance directly to customer, and has no practical control of how Customer uses the loan advance, then the potential risk of terrorist financing increases.

12.15 With the exception of a few characteristics, the features of Asset Finance render it ‘low risk’ from a money-laundering and terrorist financing perspective. An Asset Finance provider that implements sensible credit policies and procedures will be likely to avoid the higher-risk features of Asset Finance.