

11. Motor finance

Note: This sectoral guidance is incomplete on its own. It must be read in conjunction with the main guidance set out in Part I of the Guidance, and the guidance in sector 12: Asset finance.

Overview of the sector

- 11.1 Motor finance companies offer a number of products to fund the acquisition and use of a motor vehicle. Dependent upon the funding method used, the customer may or may not obtain legal title to the vehicle. Motor finance products generally fall into two categories – purchase agreements, and lease agreements.

Purchase agreements

- 11.2 *Conditional sale* is a contract between the finance company and the customer where the customer agrees to buy specific goods. It is normally a fixed cost, fixed term credit and the customer in practice exercises all the rights of the owner of the goods. However, in law, the ownership of the asset will not pass until certain conditions are met (normally that all payments under the contract have been made, but individual contracts may include other conditions).
- 11.3 *Hire Purchase (HP)* and *Lease Purchase (LP)*. These are both agreements under which the customer will hire the vehicle for a fixed period of time. During this period the motor finance company will recover, through the instalments paid, the cost of the vehicle together with its charges. Once the agreement is paid in full, the customer has the option to purchase the vehicle for a nominal sum. Generally, the difference between the two agreements is that on HP the amount to be repaid is spread evenly throughout the agreement, whereas on LP a substantial sum is deferred to the final instalment.
- 11.4 *Personal Contract Purchase (PCP)* is in essence a purchase agreement (the definition would, therefore, be the same as HP and LP) with a Guaranteed Minimum Future Value (GMFV) placed on the goods by the finance company. The customer has the choice at the end of the agreement of either paying the GMFV and obtaining title to the vehicle or returning the vehicle (and not having to pay the GMFV).
- 11.5 *Personal Loan* is an agreement where the title passes immediately to the customer and an unsecured loan is provided to cover all or a proportion of the sale price.

Leasing agreements

- 11.6 These are agreements where the customer leases the vehicle for a fixed period of time, but does not have the ability to obtain title. The motor finance company will reclaim the VAT on the vehicle and claim writing down allowances for tax purposes, as owner of the asset. A business customer can, dependent upon its tax position, claim both tax relief and proportion of the VAT on rentals paid. There are two types of lease:
- A *Finance Lease*, where the customer takes the risk in the final value of the vehicle.
 - An *Operating Lease*, where the motor finance company takes the risks and rewards in the final value of the vehicle.

- 11.7 This guidance applies to all dealer-introduced motor finance, unless otherwise stated (as in the case for operating leasing (see 11.8 below)) including, but not limited to, cars, light commercial vehicles, motorcycles and caravans. However, brokers are not covered by the money laundering regulations unless they provide finance leasing products on their own books.
- 11.8 Operating leases¹⁵ are **outside** the scope of the ML Regulations¹⁶. However, in practice for some firms it may be difficult to separate out this type of activity from other forms of leases, such as finance leases. In these circumstances ‘best practice’ would suggest that firms *may* nevertheless wish to make a commercial decision to follow this guidance in respect of this type of lease.

What are the money laundering risks in motor finance?

- 11.9 The features of all lending are generally that the initial monies advanced are paid into another bank account, in the case of motor finance in exchange for the use of a vehicle. Repayments are usually made from other bank or building society accounts by direct debit; in most, but not all, cases, repayments in cash are not, and should not be, encouraged.
- 11.10 Given that a loan results in the borrower not receiving funds from the lender, but the use of a vehicle, the initial transaction is not very susceptible to money laundering. The main money laundering risk arises through the acceleration of an agreed repayment schedule, either by means of lump sum repayments, or early termination. Early repayment can also be indicative of funds being used which have emanated from a criminal lifestyle.
- 11.11 Motor finance products therefore carry a low inherent money laundering risk. A motor finance company will normally only accept payment of instalments from the customer named on the agreement, and in the case of overpayment will only make repayment to the customer named on the agreement.
- 11.12 Should a motor finance company accept occasional payments from third parties, for example the settlement of the agreement by the dealer, and/or accept payment via payment books, it must be alert to the increased risk of receiving the proceeds of crime.

Assessment of the risk

- 11.13 The lender’s knowledge of the customer only extends to information gleaned at the identification stage, and to a single monthly payment on the agreement; their occupation details and monthly income/expenditure are generally unknown.
- 11.14 The nature of motor finance business, however, is that the type of agreement entered into with the customer carries a low risk of money laundering.
- 11.15 Procedures and controls used for identifying potential money laundering are therefore normally transactional-based, to identify unusual transactional movements, unusual deposits, unusual advance payments or unusual repayment patterns.

¹⁵ Vehicle contract hire and vehicle rental products would, for the purpose of this guide and accounting purposes, be classified as being an operating lease and as such would fall **outside** the scope of this guide. Under Financial Reporting Standard 5 (“FRS5”) and Statement of Standard Accounting Practice 21 (“SSAP 21”) operating leases would be a lease where risk and rewards of ownership do not pass substantially to the lessee.

¹⁶ Whilst Operating leases fall outside the requirements of the Money Laundering Regulations, firms should be aware of the anti-money laundering reporting requirements of the Proceeds of Crime 2002 (POCA), which covers all types of business. See, for example, paragraphs 1.36-1.37 in Part I of the Guidance.

Who is the customer for AML purposes?

- 11.16 A customer may be a private individual or a business e.g., partnerships, companies, associations etc.
- 11.17 Customers may be introduced through dealers, or by direct lending over the internet, through the post, or by telephone. Motor dealers introduce their customers to lenders whenever finance is required to support a vehicle acquisition. The dealer/lender relationship will be formalised in terms of an agency contract, and the dealer staff conducts face-to-face negotiations. Direct lending motor products may also be obtained remotely without face-to-face contact; this is likely to carry a higher risk.

Customer due diligence***Dealer-introduced motor finance***

- 11.18 In a move to reduce fraudulent credit applications, members of the Finance & Leasing Association (FLA) have subscribed to an industry standard with regard to acceptable proof of identity and the standardisation of credit application processing for face-to-face business. The procedure for customer verification involves face-to-face identity checks by the dealer, supported by subsequent validation of copy identity documents by the lender. The Industry Standard is set out in the attached Annex 11-I.
- 11.19 Compliance with the Industry Standard on proof of identity goes beyond the current money laundering requirements under simplified due diligence (SDD), which is directly relevant for low risk products such as hire purchase and leasing agreements. However, this industry standard should still be used in order to guard against fraud. On-going monitoring of the business relationship is still required under simplified due diligence (SDD).
- 11.20 Under the regulations dealers can be used as agents for customer due diligence purposes in those sectors that are currently subject to established systems of supervision for money laundering. In practice this means that credit and financial institutions authorised and supervised by the FSA for anti-money laundering compliance will be able to be relied upon, although in all cases the 'relying' firm retains ultimate responsibility for meeting the obligations under the Regulations.
- 11.21 The identification of non-personal customers e.g., partnerships, companies, associations etc. should be carried out in accordance with the guidance set out in Part I, paragraphs 5.3.115ff.

Non face-to-face applications

- 11.22 Negotiations in respect of non face-to-face applications are normally drawn out over a period, involving vehicle specification and part exchanges, and are normally conducted over the telephone. Documentation is usually sent out by post, and the vehicles may be delivered to the customer's home. Firms should be aware that non face-to-face applications by their very nature pose a greater risk and should not, therefore, be treated as lower risk under simplified due diligence (SDD). They will therefore require identification, verification and ongoing monitoring under enhanced due diligence (refer to Part I, section 5.5), as opposed to just monitoring under simplified due diligence (SDD) rules within the current regulations.
- 11.23 Electronic verification may therefore be used, supported by postal communication to home address. Some lenders may seek copies of items in accordance with the procedures set out in Part I, Chapter 5.

Supervision

- 11.24 There are several different regulatory bodies taking responsibilities under the 2007 Money Laundering Regulations. In order to aid clarity about who supervises whom the FSA have published a flow chart that helps business to understand which regulator regulates which entities. The FSA's Money Laundering regulations pages also contain other information FSA ML regulated firms may find to be of use, including their approach to registering and supervising the businesses that fall to their responsibility. Links to this information can be found at: <http://www.fsa.gov.uk/mlr>. Similar documentation for OFT registered firms can be found on the OFT's website: <http://www.ofc.gov.uk/>.

Industry Standard for Fraud Prevention in Credit Application Processing:***Standard Identification Evidence***

It should be noted that some of the requirements set out in this industry standard exceed those now required for lower risk products, e.g. some leasing agreements, under the current money laundering regulations (under simplified due diligence (SDD) they no longer require identification and verification). However these standards should still be followed as they prevent fraud which is inherently tied into money laundering.

1. In credit application processing, there should be standard acceptable proofs for verification of identity and current permanent address in accordance with paragraphs 3 - 5 below. These apply in the case of:
 - new customers; and
 - current and previous customers where the proposal details show a material discrepancy from the existing account details in the records of the lender; and
 - previous customers whose last transaction expired over 12 months ago.
2. A 'material discrepancy' would include any of the following:
 - missing/wrongly spelt names;
 - change of name;
 - incorrect address information extending to post code, current or previous address;
 - incorrect time at address; and
 - conflicting employment details, bank details, date or place of birth.
3. There should be mandatory production of a full driving licence or a photo card driving licence, or a provisional driving licence with photo card, in every case bearing the customer's current address. All photo cards should be accompanied by their relevant counterpart. Where the driving licence does not bear the customer's current address, then additional proof of current permanent residence should be required (for example, by Electoral Roll confirmation).
4. In the rare circumstances where an individual cannot produce a current driving licence, the lender should verify the identity in accordance with the procedures set out in Part I, Chapter 5.
5. The driving licence should be supported, wherever possible, by at least one of the following:
 - electronic confirmation of the customer's current residence via the Electoral Roll;
 - electronic confirmation of current credit data at the current address on existing lending;
 - electronic confirmation of identity in accordance with Part I, paragraph 5.3.79
6. The waiving or variation of any of the requirements in paragraphs 1 to 5 is permissible but at the lender's own risk and discretion provided that, as a minimum, they comply with the requirements set out in Part I, Chapter 5.

Dealers

7. Payment may be made by the lender in advance of receiving copies of the evidence of identity and address, but there should be in place an arrangement to cancel the credit agreement and recover the

funds in the event that identity cannot be verified (such a payment is made by the lender at its own risk).

8. In accordance with the normal working practice of the lender concerned, identity should be satisfactorily verified in accordance with paragraphs 3 and 4 prior to authorisation being given to the dealer to release the vehicle to the customer or before settling the dealer's invoice.
9. The dealer should have sight of original documents (not copies) and should scrutinize them for authenticity and check the signature against the credit agreement. Any photographic proof of identity should also be checked for reasonable likeness of the customer.
10. The dealer should take a copy of the original proofs and this copy of the original proofs, together with confirmation that it is a copy of the original, should be submitted to the lender for subsequent document validation checks. The lender should not accept a copy of a copy.

Scope of Industry Standard

11. This Standard applies to sole traders and individuals and should be applied, wherever practical, to the main driver of the particular vehicle for a partnership or SME.