12. Asset 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, where relevant, the guidance in sector 11: Motor finance.

Overview of the sector

12.1 Asset finance providers offer financial facilities that allow a business to use an asset over a fixed period, in return for regular payments. The business customer chooses the equipment it requires, and the finance company buys it on behalf of the business. There are a number of ways in which a business may finance an asset. These are described below.

Leasing

12.2 The fundamental characteristic of a lease is that ownership of the asset never passes to the business customer.

12.3 Under a *finance lease*, the leasing company recovers the full cost of the equipment, plus charges, over the period of the lease. It can claim written down allowances, whilst the customer can claim both tax relief and VAT on rentals paid.

12.4 An *operating lease* is often used where a business requires a piece of equipment for a shorter period of time, for example construction equipment. The leasing company will lease the equipment to the customer, expecting, at the end of the lease period, to sell it second-hand or to lease it to another customer. The business customer does not enter the operating leased item on its balance sheet as a capital item.

12.5 The most common form of operating lease is known as contract hire. Essentially, this gives the customer the use of the asset, together with additional services such as maintenance and repair of the asset. An example of an asset on contract hire would be a fleet of vehicles. In this instance, a proportion of the VAT is reclaimable by the customer.

12.6 Operating leases are outside the scope of the ML Regulations[17]. Best practice would, however, suggest that firms should nevertheless follow this guidance in respect of this type of lease. In any event, in practice it may often be difficult to separate out this type of activity from other forms of lease. For example, many asset finance businesses offer a mixture of operating and finance leases and it would therefore be unduly cumbersome to follow different procedures for different leasing products, as well as inconsistent with a risk based approach.

Purchase

12.7 *Hire Purchase* (HP) is a well-established method of financing the purchase of assets by businesses. Under a HP agreement, the customer will hire the asset(s) for a fixed period of time. During this period the asset finance company will recover, through the instalments paid, the cost of the asset(s) together with its charges. Once the agreement is paid in full, the customer has the option to purchase the asset(s) for a nominal sum.

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[17] 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.

12.8 A *lease purchase* is similar to HP, the main difference being in the terms and structure of repayments. Some finance companies differentiate lease purchase from HP by using lease purchase where the customer wishes to defer payment of a substantial part of the asset cost until the end of the agreement.

12.9 *Joint ventures* between asset finance providers are commonplace on high value transactions.

12.10 The above funding methods are a guide and include variations with or without maintenance e.g., recourse or non-recourse.

12.11 *Structured or "big ticket" asset finance* broadly covers very high value transactions. Products are highly visible and high profile, such as aircraft, ships and properties. Here, the lending tends to be higher in quality, generally being made to major reputable companies, be they public sector or at the top end of the private sector. Transactions are one-off and no deposits are generally taken. Most big-ticket financiers are subsidiaries of the major banks; business is often introduced from another part of the group and so information on the customer is contained within a group-wide database.

12.12 *Middle market products* include commercial vehicles, cars for business, plant machinery and IT equipment to a wide range of business customers.

12.13 At the *"small ticket" end of the market*, products such as photocopiers, PCs and telephone systems depreciate very quickly and offer little incentive for money laundering. Given that the asset provider owns title to the assets, there is little the end user can do with the assets.

What are the money laundering risks in asset finance?

12.14 The features of asset finance are generally that no monies are advanced to the customer, but are paid into a supplier's bank account to fund the purchase of an asset which is made available under contract to the customer. Repayments by the customer are usually made from other bank accounts by direct debit; in most, but not all, cases. Repayments in cash are not, and should not be, encouraged. Risk is also associated with hire purchase and lease products as they could be used for layering.

12.15 Given that a loan does not result in the borrower receiving funds from the lender, but the use of assets, the initial transaction is not very susceptible of 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.

12.16 Asset finance products therefore generally carry a low inherent money laundering risk. An asset 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.

12.17 In summary, the business of asset financing can be considered as carrying a low money laundering risk because:

- under a pure leasing agreement, lessees cannot acquire ownership of the asset during the term of the lease;

- payments are usually collected from other bank accounts by direct debit; and cash payments are not accepted in the normal course of business.

Assessment of the risk

12.18 In assessing customer risk, reference should be made to the risk-based approaches referred to in Part I, sections 5.4 and 5.5. These sections look at both simplified due diligence (SDD) and enhanced due diligence (EDD).

Customer due diligence

12.19 All asset finance providers should carry out full credit searches on the businesses they transact with. Additional steps to verify identity will vary across the three markets, as set out below. Note that this may well go beyond what is required by the current money laundering regulations, certainly in relation to low risk areas which can now rely on simplified due diligence (SDD). However, these additional measures will still be important for fraud purposes.

12.20 Under the regulations third parties 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.

12.21 *Big-ticket lenders* – Traditionally as part of the credit underwriting process, the lender will check that the lessee is listed on a recognised market or exchange, or is a subsidiary of such a company. The lender should also check whether the lessee is a local authority. Where the customer is not listed, the standard verification requirement set out in Part I, paragraphs 5.3.149 – 5.3.153 is usually followed, including appropriate verification of the identity of the beneficial owners. Where appropriate, verification of the identity of the directors in principal control, and company searches, will be undertaken as part of normal underwriting procedures.

12.22 Prior to agreeing to finance an asset, the lessor will sometimes visit the lessee. There should be an understanding of the client's business; for example, that the nature of the asset for which funding is sought is consistent with the business.

12.23 *Middle market asset financiers* also follow the procedures set out in Part I, section 5.3, making full use of data held by credit reference agencies. This will verify key parties/directors, including beneficial owners. As with providers of structured asset finance, prior to agreeing to finance an asset, the lessor will usually visit the lessee and have an understanding of the client's business. However, in applying a risk-based approach, middle market asset financiers may take appropriate account of the guidance on using the source of funds as evidence of identity given in Part I, paragraphs 5.3.92- 5.3.96. There will be variations, depending on whether a company is listed on a regulated market or exchange, and other exceptions which may be relevant as set out in Part I, Chapter 5.

12.24 *Small ticket lender*s may be able to rely on simplified due diligence (SDD) as set out in Part I, section 5.4 and are, therefore, no longer required to verify identity in accordance with the standard requirements set out in Part I, paragraphs 5.3.115 - 5.3.278. This is because this is a particularly low risk area. However, for fraud purposes lenders should still carry out identity verification in accordance with standard practice.

12.25 There may be variations, depending on whether a company is listed on a regulated market or exchange, and other exceptions which may be relevant as set out in Part I, Chapter 5.

12.26 Where identity is still required for a transaction which may be seen as higher risk the Asset finance business would be able to use the source of funds as evidence of identity (see Part I, paragraphs 5.3.92 – 5.3.96), provided that repayment is to be made by direct debit from an account that can be confirmed at the outset as being in the borrower's name. However, where the sum being lent is to be paid direct to the customer's supplier, sufficient due diligence must be carried out to ensure that the supplier is genuine.

12.27 For sole traders or small partnerships, the standard identification requirement set out in Part 1, paragraphs 5.3.163 - 5.3.166 should be followed. Where the risks are considered at their lowest, firms may be able to carry out simplified due diligence as set out in Part I, section 5.4.