ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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Moneylenders

Sector Specific AML/CFT Guidance Notes

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Whilst this publication has been prepared by the Financial Services Authority, it is not a legal document and should not be relied upon in respect of points of law. Reference for that purpose should be made to the appropriate statutory provisions.

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1. Foreword

"Money Lenders" is the collective term used to describe the businesses detailed as (ff), (gg) and (hh) of Schedule 4 to the Proceeds of Crime Act 2008 ("POCA") as detailed below:

(ff) subject to paragraph (4), the business of lending including, but not limited to, consumer credit, mortgage credit, factoring and the finance of commercial transactions in respect of products other than consumer products for and on behalf of customers;
(gg) subject to paragraph (4), the business of providing financial leasing arrangements in respect of products other than consumer products for and on behalf of customers;
(hh) subject to paragraph (4), the business of providing financial guarantees and commitments in respect of products other than consumer products for and on behalf of customers.

(4) A business is not in the regulated sector by reason only of the provisions of subparagraphs (1)(ff), (gg) or (hh) if the lending, leasing or provision of guarantees or commitments (as the case may be) is made by -

(a) a parent undertaking to a subsidiary of that parent undertaking;
(b) a subsidiary of a parent undertaking to the parent undertaking; or
(c) a subsidiary of a parent undertaking to another subsidiary of that parent undertaking.

By virtue of being included in Schedule 4 to POCA this sector is subject to the requirements of the Anti-Money Laundering and Countering the Financing of Terrorism Code 2015 ("the Code"). Also, this sector is included in the Designated Businesses (Registration and Oversight) Act 2015 which came into force in October 2015. The Financial Supervision Authority now has the power to oversee this sector for Anti-Money Laundering and Countering the Financing of Terrorism ("AML/CFT") purposes.

The Authority would like to thank the Office of Fair Trading for their assistance in developing this sector specific guidance.

2. Introduction

The purpose of this document is to provide some guidance specifically for the Money Lenders sector. This sector specific guidance should be read in conjunction with the main body of the AML/CFT Handbook. It should be noted that guidance is not law, however it is persuasive. Where a person follows guidance this would tend to indicate compliance with the legislative provisions, and vice versa.

This document will cover unique money laundering and financing terrorism ("ML/FT") risks that may be faced by the Money Lenders sector and will provide further guidance in respect of customer due diligence measures ("CDD") where a once size fits all approach may not work. Also, some case studies are included to provide context to these unique risks. The information included in this document may be useful to relevant persons to assist with their risk assessment obligations under the Code.

This document is based on the 2007 FATF report *Money Laundering and Terrorist Financing through the Real Estate Sector*[1] which includes some detail on money lending businesses The Authority recommends that relevant persons familiarise themselves with this, and other typology reports concerning the Money Lenders sector.

3. Risk Guidance

Guidance in relation to conducting risk assessments is provided under Part 3 of the AML/CFT Handbook. This section aims to provide further guidance to the risks generally unique to this sector. The services of the legal sector may be used by money launderers to provide an additional layer of legitimacy to the criminal's financial arrangements, especially where the sums involved may be larger.

The business of lending (including financial leasing and providing financial guarantees) is not typically vulnerable to the placement stage within the traditional three stage money laundering process. There is, however, significant scope for credit providers to be drawn in to the layering and integration stages, and as illustrated below, this is not uncommon.

According to typology reports, the most common vulnerability faced by lenders is where cash is drawn down from the provider and then repaid with the proceeds of crime, either very quickly afterwards or over a generally short repayment period effectively exchanging the criminal proceeds with the clean money from the loan provider. This then provides the criminal with documented evidence of seemingly legitimate source of funds.

As noted above, the main ML risks arise through the acceleration of an agreed repayment schedule, either by means of lump sum repayments, or early termination or settlement. Lenders should be aware that early repayments carry a risk that the funds have emanated from a criminal lifestyle.

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.

If a lender accepts occasional payments from third parties, for example, on settlement of the agreement, it must be alert to the unknown nature of the source of these funds, which may increase the risk of receiving the proceeds of crime.

Repayments should normally be made from the customer's own bank or building society accounts by direct debit. Repayments in cash are not ideal (due to inherent risks such as the

[1] http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf

lack of audit trail and difficulty in establishing the source of the cash), and should not be encouraged.

Where a cash loan is made the lender should ensure that the loan monies are credited to the account from which the repayments are to be made as a preventative measure against fraud.

4. High Risk Indicators

As with the basic elements of a risk assessment discussed under Part 3 of the AML/CFT Handbook, the following list provides examples of factors or activities that are likely to indicate a higher risk of ML/FT and should warrant further attention or scrutiny by the firm (just because a feature is listed below it does not automatically make the relationship high risk, provided suitable controls are in place.

As with all types of risk assessment, a holistic approach should be taken and the indicators below should be taken into consideration along with a wide range of other factors:

1. The customer is overly secretive or evasive about:
    - their identity;
    - who the beneficial owner is (if applicable);
    - the source of funds; and / or
    - the nature and intended purpose of the business relationship including, for example, why they need a loan.

2. The customer:
    - is using an agent or intermediary with no apparent legitimate reason;
    - is actively avoiding personal contact with no apparent legitimate reason;
    - is reluctant to provide or refuses to provide information, data and documents usually required in order to enable the transaction's execution
    - provides false or counterfeited documentation;
    - is a business entity which cannot be found on the internet and/or uses an email address with an unusual domain part such as Hotmail, Gmail, Yahoo etc. especially if the customer is otherwise secretive or avoids direct contact;
    - is known to have convictions for acquisitive crime (meaning a crime that generates proceeds), known to be currently under investigation for acquisitive crime or have known connections with criminals;
    - is or is related to or is a known associate of a person known as being involved or suspected of involvement with terrorist or terrorist financing related activities; and / or;
    - is prepared to pay substantially higher fees than usual with no apparent legitimate reason.

3. The customer has changed lender a number of times in a short space of time or is using multiple lenders at the same time without legitimate reason.
4. The required service was refused by another lender or the relationship with another professional was terminated.

5. There is an absence of documentation to support the customer's explanations, previous transactions, or business activities.
6. There are several elements in common between a numbers of transactions in a short period of time with no apparent legitimate reason.
7. Abandoned transactions with no concern for the fee level or after receipt of funds.
8. There are unexplained changes in instructions, especially at the last minute.
9. The customer wishes to repay earlier than anticipated and is unwilling to provide a rationale as to why and the source of the new funds.
10. The customer is not concerned with early repayment fees, interest rates or other charges.
11. The customer who draws down the loan is not the same party repaying the loan.
12. The customer overpays the loan and seeks to claim back the difference.

5. Case Studies

The typologies below are real life examples of risks that have crystallised causing losses and/or sanctions (civil and criminal) against the money lending sector:

5.1. Back-to-back loan used to launder funds

An individual set up two companies in different jurisdictions. He used a front man and a trust and company service provider as legal representatives to hide his involvement. One of the companies, led by the front-man, owned real estate and generated income through rental activity. He set up a back-to-back (fiduciary) loan structure to use his criminal money for his real estate investments. He then arranged a bank guarantee between two banks in case of a default of the loan. The bank was willing to provide the bank guarantee with the pledged deposit of one of his companies as collateral. The money placed as a deposit was generated by the individual's criminal activity.

Higher risk indicators identified in the scheme include:

- No reference in the loan agreement to the underlying collateral.
- The collateral provided was not sufficient.
- The collateral provider and other parties involved in the loan structure were not known.
- The borrower of the money was not willing to provide information on the identity and background of the collateral provider and/or the other parties involved in the loan structure.
- The complex nature of the loan scheme could not be justified.
- There was an unexpected loan default.

(based on The 2007 FATF report *Money Laundering and Terrorist Financing through the Real Estate Sector)*[2]

[2] http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf

5.2. Use of illegal funds in mortgage loans and interest payments

An individual used a front-man to purchase real estate. The value of the real estate was manipulated by using a licensed assessor (real estate agent) to set up a false higher but plausible assessment of the market value of the property after renovation. The bank was willing to grant a mortgage on the basis of this false assessment. After the disbursement of the loan the real estate was paid for. The remaining money was then transferred by the owner to bank accounts in foreign jurisdictions with strict bank secrecy. The renovation took never place. The company finally went into default and the loan could not be reimbursed.

Higher risk indicators identified in the scheme include:
- Applying for a loan under false pretences.
- Using forged and falsified documents.
- The client persisted in representing his financial situation in a way that was unrealistic or that could not be supported by documents.
- The loan amount did not relate to the value of the real estate.
- Successive buying and selling transactions of the real estate were involved.
- The client had several mortgage loans concerning several residences.

(based on The 2007 FATF report *Money Laundering and Terrorist Financing through the Real Estate Sector)*