

Does lending to subsidiary automatically make company subject to AML law? (2/4/20)

We have lately heard that it is advisable to register your company as a person subject to the Anti Money Laundering and Counter Terrorist and Proliferation Financing (AML/CTPF) Act rather than receiving a letter from the State Revenue Service (SRS) warning that they are about to examine your system of internal controls, which does not exist. This article explores how much of this talk is true.

Persons governed by the AML/CTPF Act etc

Persons governed by the AML/CTPF Act include a person that provides lending services and finance lease services and whose professional activities are not subject to licensing. No questions are asked about entities that have declared their business activity and receive income from that activity only. But how about entities that lend to related companies for a stated purpose, say, to develop their manufacturing or boost their current assets? Let us use an example to better understand where the entity and the SRS stand.

A holding company has lent to its subsidiaries. Is the holding company considered a person subject to the AML/CTPF Act? If so, the company must be registered as such.

Does the lender's shareholding percentage matter, for example, where the subsidiary is wholly owned by the parent? And where a shareholder makes a loan to a subsidiary, say, strictly for business purposes, and is able to prove this, is he also considered a person subject to the AML/CTPF Act required to set up a system of internal controls?

Section 3 of the AML/CTPF Act lists all persons that are subject to it. Section 45(1) lists the supervisory and control bodies for particular categories, while section 45(2) lists categories unspecified by section 45(1) that are supervised by the SRS. Section 45(2)(6)(a) provides that the SRS supervises lending institutions and finance companies that are not subject to licensing.

According to comments made by the SRS, article 3(2)(a) of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 provides that a financial institution is an undertaking other than a credit institution, which carries out one or more of the activities listed in points (2) to (12), (14) and (15) of Annex I to Directive 2013/36/EU of the European Parliament and of the Council, including the activities of currency exchange offices. Those points list financial services, including point (2) specifies lending, including consumer credit, credit agreements relating to immovable property, factoring with or without recourse, and financing of commercial transactions (including forfaiting). So an entity that registers and specifies lending as its business activity must register as a person subject to the AML/CTPF Act and set up a system of internal controls.

Most companies wonder why the parent is considered a person subject to the AML/CTPF Act. However, dishonest operators often use lending to separate funds from their illegal origin. Loans are often used in the course of money laundering to conceal the origin of funds or to put multiple layers on a transaction.

Accordingly, to stop loans being used for money laundering purposes, the honest entities will have to meet

the new regulatory requirements and set up a separate system of internal controls to be able to prove that their funds come from a clean source and that the company knows its customer and its related party as well.