Trends and Red Flags in Unregulated Online Money Lending Activities

Unregulated online money lending products and services have shown a sharp increase recently in Sri Lanka and this type of activities increase the risk of criminal groups using such services to launder illegal proceeds. Therefore, such money lending businesses which is cash incentive could intensify the risks related to money laundering and terrorist financing. There are various such instant loan schemes that operate in an unregulated financial space in Sri Lanka. They are operating in the form of individuals, sole proprietors, partnerships or companies. The FIs are advised to exercise due diligence to avoid their institutions being exploited by criminals operating in the guise of money lending businesses.

1. Typology – Unravelling an international illicit financial network behind the local money lending business.

The FIU analyzed several suspicious transaction reports (STR) submitted by reporting entities based on the underlying suspicion of remittances from high-risk countries. The analysis by FIU revealed the following:

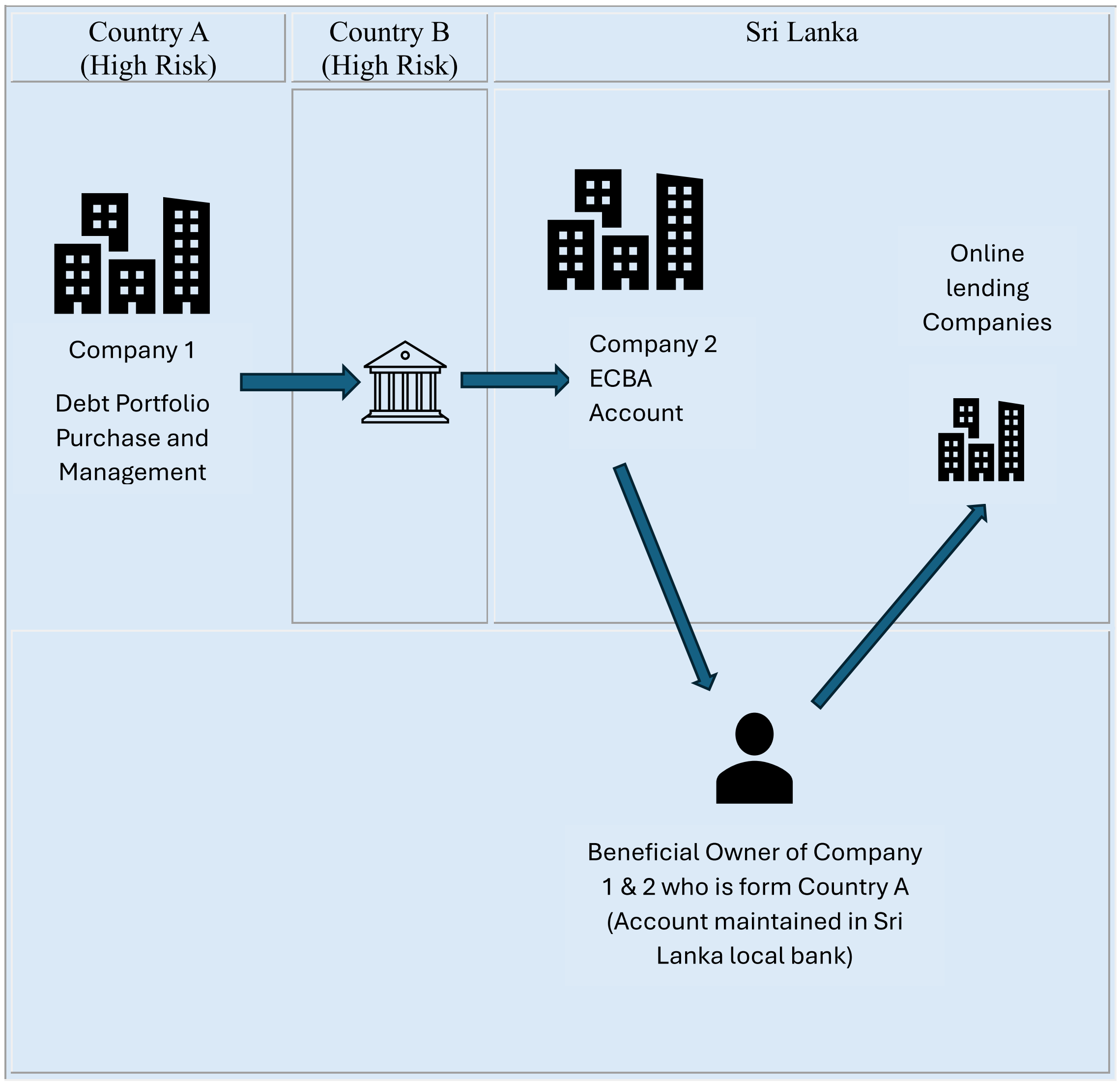
i. A company (Company 1) incorporated in country ‘A’ (identified as a high-risk country) which is engaged in debt portfolio purchase and management under micro finance business has sent several remittances to a company incorporated in Sri Lanka (Company 2). Beneficial owner of both companies is the same foreign national from the high-risk country ‘A’. Funds have been remitted from country A, through country B (another high-risk country) to an extended commercial borrowings account (ECBA) maintained by Company 2. Funds were subsequently transferred to individual accounts of the beneficial owner maintained at a local bank and then directed to accounts of several other online lending companies which have different names.

ii. The funds routed to these cash incentive lending institutions (also known as balance sheet lending) in the guise of investments had following characteristics.

    a. Investment of funds in money lending, which is a cash incentive business and funds are transferred among several companies which are formed for the purpose of money lending/ online lending.

b. Several lending companies offering lending products to public through different lending platforms were interlinked and large sum of money was transferred among

Diagram 1: Money flow of the remittance from high-risk country



these companies which the beneficial owners are foreign nationals from high-risk jurisdictions.

c. Establishment of companies through Sri Lankan Nationals as initial directors and subsequently changing the ownership to foreign nationals from high-risk countries for money laundering.

d. Analysis of money trail and links between different counterparties revealed that involved individuals who are beneficial owners are politically exposed, sanctioned, having allegations of corruption, embezzlement, and links to possible arms dealing or other similar activities.

e. The funds received into Sri Lanka were transferred among different lending companies and also used for lending to public for high interest rates. Analysis also may reveal a pattern of these funds being routed to foreign entities which are similar lending institutions established in other countries.

f. Possibility of exploiting the company secretaries in Sri Lanka for incorporation of companies by foreign individuals without proper controls or due diligence.

g. Indicated a pattern of declaring financial losses despite high turnover which indicates an attempt to evade tax.

2. Red flags associated with money laundering in money lending product and services include:

2.1. **Source of funds**: Questionable source of funds, or transactions involving private funding or funds originating from a foreign company (often high-risk jurisdiction) without apparent logical purpose.

2.2. **High-risk or complex investments**: A large portion of a client's wealth comes from high-risk or complex investments from countries with high levels of corruption, sanctioned, or known as high risk countries for money laundering.

2.3. **Transaction Pattern**: Frequent, large, or unusual transactions, frequent cross-border transactions, transactions that are inconsistent with the customer's business profile, transactions with high-risk countries or transactions involving sanctioned customers, PEPs or customers that are the subject of adverse media.

2.4. **Complex ownership**: Complex ownership structures which have vague our unclear beneficial ownership information or construct front companies, or frequent changes in ownership.

2.5. **Structuring**: Beneficial owners of lending companies making multiple online loan transactions or wire transfers in a manner that indicates structuring.

2.6. **Suspicious Individuals**: Beneficial owners who provide vague or doubtful documents, who refuse to provide personal identification documents, sanctioned, or who are involved with sanctioned entities. Individuals in high positions, such as foreign government officials, who may be more vulnerable to corruption.

2.7. **Suspicious Entities**: Some of these companies have mother companies or subsidiaries established in other countries which are hard to trace due to absence of proper footprint with or without registration in specific jurisdiction.

Accordingly, Financial Institutions are required to perform proper customer due diligence procedures when entering into business relationships and in the course of doing business as required by the Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 to ensure that the financial institutions are not being used as a conduit for money laundering and terrorist financing.