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# TOWARDS BETTER AML PRACTICE REAL ESTATE SCOPING PAPER

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Printed on 100% recycled paper.

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This project has been funded by the Hewlett Foundation



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## INTRODUCTION

Transparency International is leading a three-year project **Towards Better AML Business Practices**, aiming to improve the implementation and effectiveness of anti-money laundering (AML) standards and practices in selected sectors including the real estate sector.

Professionals such as real estate agents are at the fore front of the fight against money laundering, playing an essential gatekeeping role in preventing, detecting and reporting suspicious activities. This scoping paper provides a summary overview of recent research into money laundering risks and policy gaps in the real estate sector.

The Financial Action Task Force (FATF) has included real estate agents in the FATF 40 Recommendations as a Designated Non-Financial Business and Profession, ‘when they are involved in transactions for their client concerning the buying and selling of real estate’. The sector is therefore subject to the relevant preventive measures, including Customer Due Diligence (CDD), suspicious reporting, and record keeping. An interpretive note clarifies that real estate agents should comply with CDD requirements ‘with respect to both the purchasers and vendors of the property’. According to FATF, real estate accounted for up to 30 per cent of criminal assets confiscated worldwide between 2011 and 2013.<sup>1</sup>

Transparency International UK’s research shows that 75 per cent of UK properties under investigation for corruption between 2004 and 2015 were registered with offshore companies incorporated in secrecy jurisdictions, such as the British Virgin Islands, where details about company beneficial ownership are not available.<sup>2</sup> Shell companies and trusts face little to no scrutiny when purchasing high-end properties. Even in cases where a series of red flags are present – such as company incorporation in a tax haven, full payment in cash or through law firms’ pooled accounts and closure of a deal through an intermediary – real estate agents and other professionals facilitating the transaction are unlikely to report suspicious transactions or cancel the deal.

In 2015, a series of articles published by the New York Times<sup>3</sup> revealed the consistent lack of due diligence by the real estate sector in the US, including failure to identify buyers or their sources of income. While many of these companies may be engaged in legitimate business, many are also used to launder illicit funds and hide the identities of corrupt politicians, businesses, and organised criminal groups.

For instance, an investigation found that the opaque ownership and control structure of a company in possession of a US\$15.6 million condominium in the Time Warner Center conceals its links to the family of the former Russian Senator and banker Vitaly Malkin. Malkin has been under investigation in a number of countries due to his involvement in a deal to restructure Angola’s \$5 billion debt to Russia, for which he is alleged to have received kickbacks.<sup>4</sup>

In 2017, a follow-up TI UK report looked at the ownership of 14 landmark London developments, worth at least £1.6 billion. It found 4 in 10 of the homes in these developments have been sold to

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<sup>1</sup> FATF, ‘Money laundering and terrorist financing vulnerabilities of legal professionals’, Paris: FATF, 2013. [www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf)

<sup>2</sup> TI UK, ‘Corruption on your doorstep’, 2015.

<sup>3</sup> Storey, L., ‘Inside the towers of secrecy’, *New York Times*, 19 February 2015. [www.nytimes.com/times-insider/2015/02/19/inside-the-towers-of-secrecy/?\\_r=0](http://www.nytimes.com/times-insider/2015/02/19/inside-the-towers-of-secrecy/?_r=0)

<sup>4</sup> Storey, L. and S. Saul, ‘Stream of foreign wealth flows to elite New York real estate’, *New York Times*, 7 February 2015. [www.nytimes.com/2015/02/08/nyregion/stream-of-foreign-wealth-flows-to-time-warner-condos.html](http://www.nytimes.com/2015/02/08/nyregion/stream-of-foreign-wealth-flows-to-time-warner-condos.html)

investors from high corruption risk countries or those hiding behind anonymous companies. Less than a quarter had been bought by buyers based in the UK.<sup>5</sup>

Research by Transparency International Canada has found that nearly half of the 100 most valuable residential properties in Greater Vancouver are held through structures that hide their beneficial owners. Nearly one-third of the properties are owned through shell companies, while at least 11 percent have a nominee listed on title.<sup>6</sup>

Lastly, in France the Financial Intelligence Unit TRACFIN has recently identified the real estate sector as a primary channel for money laundering in the country. Out of a total of 62 thousand suspicious reports sent to TRACFIN in 2016, only 84 came from real estate agents, despite nearly one million transactions taking place that year.<sup>7</sup>

These findings are linked to widespread gaps in anti-money laundering policy. A 2014 OECD assessment shows that almost a half of OECD countries do not adequately regulate gatekeepers: in 44 per cent of OECD countries, they are not required to conduct due diligence or keep records of transactions.<sup>8</sup>

## REAL ESTATE: AML POLICY GAPS

In 2017, Transparency International published a report called Doors Wide Open, which identified 10 common gaps in anti-money laundering policy and practice, drawing on policy analysis and desk research carried out for Australia, Canada, the UK and the US.<sup>9</sup> A number of these gaps have also been identified in research subsequently carried out by Transparency International Switzerland.

### 1. Inadequate coverage of anti-money laundering provisions

None of the countries analysed – Australia, Canada, the UK or the US – is fully compliant with their international commitments on anti-money laundering. They all fail to extend due diligence requirements to the full range of non-financial professionals and businesses that might be involved in the buying and selling of real estate.

### 2. Identification of the beneficial owners of legal entities, trusts and other legal arrangements is still not the norm

Only in the UK are professionals involved in real estate closings required to identify the true, actual person who is the beneficial owner of the property as part of their due diligence process. In

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<sup>5</sup> TI UK, 'Faulty Towers: Understanding the impact of overseas corruption on the London property Market', 2017. <http://www.transparency.org.uk/publications/faulty-towers-understanding-the-impact-of-overseas-corruption-on-the-london-property-market/#.WlceX3Zrx1t>

<sup>6</sup> TI Canada, 'No Reason to Hide: Unmasking the Anonymous Owners of Canadian Companies and Trusts', 2016. <http://www.transparencycanada.ca/wp-content/uploads/2017/05/TIC-BeneficialOwnershipReport-Interactive.pdf>

<sup>7</sup> Le Monde, 'Blanchiment d' Argent: les agents immobiliers font-ils preuve de complaisance?', 29 December 2017, [http://www.lemonde.fr/societe/article/2017/12/29/blanchiment-d-argent-les-agents-immobiliers-en-premiere-ligne\\_5235527\\_3224.html](http://www.lemonde.fr/societe/article/2017/12/29/blanchiment-d-argent-les-agents-immobiliers-en-premiere-ligne_5235527_3224.html)

<sup>8</sup> OECD, 'Illicit financial flows from developing countries: Measuring OECD responses', 2014. [www.oecd.org/publications/measuring-oecd-responses-to-illicit-financial-flows-from-developing-countries-9789264203501-en.htm](http://www.oecd.org/publications/measuring-oecd-responses-to-illicit-financial-flows-from-developing-countries-9789264203501-en.htm)

<sup>9</sup> Transparency International, 'Doors Wide Open: Corruption and Real Estate in Four Key Markets', 2017. [https://www.transparency.org/whatwedo/publication/doors\\_wide\\_open\\_corruption\\_and\\_real\\_estate\\_in\\_four\\_key\\_markets](https://www.transparency.org/whatwedo/publication/doors_wide_open_corruption_and_real_estate_in_four_key_markets)

Australia, Canada and the US the law does not require real estate agents, lawyers, accountants, notaries or any other person involved in real estate closings to identify the beneficial owner of customers.

### 3. Foreign companies have access to the real estate market with few requirements or checks

There are few requirements and checks on foreign companies and individuals wishing to purchase property. In all the four countries, foreign companies do not need to provide information on their real owners to any sort of company registry in order to purchase property or to the land registry upon registration. Australia is the only country that has any checks on foreign investment, but these are not designed to prevent money laundering. The UK has committed to adopt legislation to establish a register disclosing information on the beneficial owners of foreign companies owning or seeking to purchase property by April 2018.

### 4. Over-reliance on due diligence checks by financial institutions leads to cash transactions going unnoticed

Three of the four countries do not require a sufficient range of professionals to conduct the necessary due diligence checks on real estate transactions. They rely heavily on checks by financial institutions alone, which may lead to cash transactions going unnoticed. In Australia and the US, only financial institutions have anti-money laundering obligations in the real estate sector. In Canada, the anti-money laundering framework includes other relevant actors, but fails to cover categories that play important roles in the sector, such as lawyers and Quebec notaries. The UK obliges a wider range of professionals operating in the sector to conduct due diligence.

### 5. Insufficient rules on suspicious transaction reports and weak implementation

In Australia and the US, professionals involved in real estate closings are not required to submit suspicious transaction reports (STRs). In Canada, real estate agents and developers, accountants and British Columbia notaries are required to submit an STR to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) if they have reasonable grounds to suspect that the transaction is related to a money laundering offence or a terrorist activity financing offence, but lawyers and Quebec notaries are not subject to this requirement. In the UK, real estate agents, accountants and lawyers are required to submit an STR if they suspect money laundering.

### 6. Weak or no checks on politically exposed persons and their associates

In Australia, Canada and the US, professionals involved in real estate closings are not required to verify whether customers are politically exposed persons (PEPs), or family members or close associates of PEPs. This means that they do not have to conduct enhanced due diligence in these cases. In the UK, enhanced due diligence must be applied in the case of foreign PEPs, but not domestic PEPs.

### 7. Limited control over professionals who can engage in real estate transactions: no “fit and proper” test

None of the countries analysed have “fit and proper tests” for professionals working in the real estate sector, in order to assess whether they are aware of their anti-money laundering obligations. Only the UK requires real estate businesses to register with Her Majesty’s Revenue and Customs (HMRC) for anti-money laundering supervision, but compliance with this obligation is low.

## 8. Limited action by authorities regarding money laundering risks in the sector

National money laundering risk assessments have been conducted in Canada, the UK and the US and in all cases high risks of money laundering have been reported in the real estate sector. In Australia, while no risk assessment has been conducted in the past six years, current government documents highlight high risks of money laundering in the real estate sector. Despite these assessments, governments have been slow to adopt mitigation measures against the vulnerabilities identified.

## 9. Inconsistent supervision

In Australia and the US, professionals involved in real estate closings are not subject to anti-money laundering obligations, and therefore are not monitored by competent authorities or self-regulated bodies. In the UK, the supervisory regime is inconsistent, with different supervisory bodies tasked with regulating or supervising different professions connected to the real estate sector, not all of which take a risk-based approach to supervision. In Canada, FINTRAC is the sole supervisory body for compliance with the anti-money laundering and terrorist financing legislation and takes a risk-based approach to supervision, but enforcement of the rules in the real estate sector is still limited.

## 10. Lack of sanctions

In all four countries, supervisory bodies publish limited information on their enforcement efforts in the real estate sector. Both administrative sanctions for non-compliance with anti-money laundering obligations and criminal sanctions for involvement in money laundering schemes and predicate offences seem to be rare. While several financial institutions have been sanctioned for their involvement in money laundering in recent years, very little is known about the sanctions incurred by real estate agents, lawyers, accountants and notaries for facilitating money laundering into the real estate sector.

In 2017, TI Switzerland’s report “Open Doors for Illicit Money” found a number of similar weaknesses in the Swiss AML legislation. For example, the scope of the current anti-money laundering law does not fully apply to the main actors in a real estate transaction, such as notaries and real estate agents. Legal due diligence and suspicious reporting requirements are generally limited to the financial intermediaries involved in the transaction. These financial intermediaries, however, are in most cases not sufficiently involved in transactions to detect money laundering.

In addition, the report found that the highest money laundering risks in Switzerland can be found when real estate is acquired by foreign nationals, and specially when foreign legal entities are involved in transactions. The gaps in the Swiss anti-money laundering system are compounded by the characteristics of the Swiss property register, which has incomplete data and has a complicated system to request information. As a result, it is relatively easy to acquire Swiss real estate with illicit proceeds and go undetected.<sup>10</sup>

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<sup>10</sup> TI Switzerland, ‘Offene Türen für Illegale Gelder’, 2017. <https://transparency.ch/publikationen/offene-tueren-fuer-illegale-gelder-geldwaescherei-im-schweizer-immobiliensektor/>

## FATF REPORTS: LIMITED COVERAGE OF SECTOR PERSPECTIVES

The analysis in the most recent round of FATF Mutual Evaluation Reports (MERs) confirm the existence of substantial gaps in regulatory frameworks and practical AML effectiveness in the sector. These FATF reviews mostly focus on the applicable legal requirements for real estate agents, as well as on the role of supervisors. Beyond data on SARs submitted (which tend to be low in number) FATF reports have limited references to private sector AML perspectives and public-private interaction.

For example, in Australia FATF found that “The laundering of foreign proceeds of crime in Australia (particularly in the real estate sector) was acknowledged by some of the authorities and much of the private sector as a high ML risk, but assessors’ attention was not drawn to any national policies explicitly targeting or prioritising this risk. Of great concern is that Australia has not brought real estate agents within the AML/CTF regime.”

It also noted that “Most designated non-financial business and profession sectors are not subject to AML/CTF requirements, and did not demonstrate an adequate understanding of their ML/TF risks or have measures to mitigate them effectively. This includes real estate agents and lawyers, both of which have been identified to be of high ML risk in Australia’s National Threat Assessment.”<sup>11</sup>

In the US FATF report the main reference to the real estate sector perspective states “Neither the real estate agents nor the RMLO [mortgage lending] sector appeared to understand what the ML risks in relation to high-end real estate are or what the appropriate mitigation measures would be.” Referring to voluntary guidance by the NRA [National Realtors Association] and law associations, the FATF report adds: “However, it is not clear to what extent the voluntary guidance is applied within these sectors.”<sup>12</sup>

One of the few references to the need for regulatory guidance comes from the FATF report on Spain: “There is not enough guidance on AML/CFT high risks and related obligations. On the risks, some sectors which are acknowledged to be high risk (such as the real estate sector and foreign criminals) are not the subject of specific guidance, information or typologies which could help obliged entities to detect and report suspicious activity.” FATF also noted that “Guidance should include specific information or typologies with relevant indicators to the private sector on the risks related to foreign criminals in combination with real estate in order for the private sector to be able to detect related ML and report STRs.”<sup>13</sup>

## SELECTED RECOMMENDATIONS

The following set of selected reforms and measures are drawn from the TI Doors Wide Open report, based on international commitments such as the FATF Recommendations and the G20 High Level Principles on Beneficial Ownership Transparency.

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<sup>11</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Australia-2015.pdf>

<sup>12</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf>

<sup>13</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Spain-2014.pdf>

## Coverage of anti-money laundering provisions should be adequate

- Governments should amend the rules to require all reporting entities involved in real estate transactions to conduct due diligence on customers. These would include real estate agents and other relevant individuals or entities, such as lawyers and law firms, accountants, notaries, mortgage lenders and other corporate service providers who engage in the buying and selling of real estate.

## The identification of the beneficial owners of legal entities, trusts and other legal arrangements should become the norm

- Governments should require that real estate agents and other individuals or entities who engage in the buying and selling of real estate identify and keep records on the beneficial owners of customers before proceeding with the sale or purchase.

## Foreign companies should only gain access to the real estate market upon providing information on their real owners

- Governments should require foreign companies that wish to purchase property in a country to provide information on their beneficial owners, including the name, nationality, date of birth, address, and how control is exercised.
- This information should be available to law enforcement and preferably made available in open data format in a public beneficial ownership registry.

## Suspicious transaction report rules are adequate and implemented

- Professional associations or supervisory bodies should provide guidance on the identification of “red flags” and submission of STRs to professionals operating in the sector to increase both the quantity and quality of STRs submitted.

## Professionals who can engage in real estate transactions should be regulated and submit to “fit and proper” tests.

- Governments should require real estate agents to register with a designated public authority and take a “fit and proper” test, in order to operate in the real estate sector. Anti-money laundering training should be made compulsory upon registration.
- Licensing bodies should include knowledge of anti-money laundering obligations among the requirements to acquire a licence.
- Professional associations should support anti-money laundering efforts in the sector by including anti-money laundering in their professional certification programmes.

## Money laundering risks in the sector should be understood and fully acted upon

- Governments should use the findings of regular risk assessments to improve the legal framework as well as supervision and enforcement efforts.
- Reporting entities should conduct their own assessments of risks and also use the findings of the national risk assessment to design their compliance systems and provide anti-money laundering training to staff.

- Governments should determine a single independent supervisory body to oversee reporting entities' compliance with anti-money laundering and terrorist financing legislation and regulations, using a risk-based approach.

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