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WHITE PAPER

AML Compliance in the Real Estate Sector

A house built upon the sand?

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By Trevor Barritt, October 2023

As Safe as Houses

The real estate sector is a relative safe haven for illicit money laundering activities, largely due to the scale and complexity of transactions involved. Each year, billions of dollars are laundered through this sector. In a paper published in June 2023, the Financial Action Task Force (FATF) concludes that real estate accounted for up to 30% of criminal assets confiscated in the last two years[1]. And yet, the sector appears to be a backwater when it comes to regulation and enforcement. It is the aim of this article to examine why the global real estate market is one of the favourite targets for financial crime and what can, should, and in the short term, will be done about it.

Another reason real estate transactions, typically involving large sums of money, are particularly attractive for money laundering activities is that they provide an effective means for criminals to introduce their illicit funds into the legitimate economy, thereby masking the original source of the capital. The process often involves intricate layers of transactions and can involve shell corporations, making it challenging to track and trace the movement of funds.

Moreover, the international nature of many real estate deals adds another layer of complexity, as cross-border transactions are notoriously difficult to monitor. Recognizing this, the FATF has stated that "real estate has long been recognized as a sector vulnerable to abuse for money laundering (ML) purposes,"[2] emphasising the need for effective oversight and regulation.

In common with trade finance, a real estate transaction has the veneer of legitimacy. There is an obvious ostensible reason for the transaction. The OECD[3] identifies many vulnerabilities in this sector. In their own words, these include:

- Rapidly increasing prices
- Easily inflated/delated prices of properties
- The possibility to conceal ownership:
    - » Difficulty to identify the beneficial owners of offshore companies and/or through a complex structure of ownership
    - » Acquisition of properties overseas
    - » Use of nominees
    - » High real estate turnover combined with rapidly changing hands
- Complexity, including the number of intermediaries involved
- Difficulty in obtaining timely and accurate information

> "
> ***Real estate accounted for up to 30% of criminal assets confiscated in the last two years***

An Unregulated Sector

According to the think tank Global Financial Integrity,[4] between 2015 and 2020, $2.3 billion was laundered through the US real estate market alone, with politically exposed persons (PEPs) involved in around half of this figure. This large sum pales into insignificance when compared to the UK. Transparency International reports[5] that £6.7 billion in "questionable funds" was invested in the UK real estate market between 2017 and 2021.

£6.7 billion

Amount of 'questionable funds' invested in the UK real estate market between 2017 and 2021.

source: Global Financial Integrity

The disparity between the two countries becomes even more apparent when considering that one figure is in GBP and the other in USD, and the difference in population size. If we adjust for this, the UK equivalent figure becomes a massive $42.5 billion

[1] Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals, June 2023
[2] Guidance For a Risk-Based Approach - Real Estate Sector – FATF – July 2022
[3] www.oecd.org/ctp/excange-of-tax-information/42223621.pdf
[4] Acres of Money Laundering: Why U.S. Real Estate is a Kleptocrat's Dream - Global Financial Integrity (gfintegrity.org)
[5] Stats reveal extent of suspect wealth in UK property and Britain's role as global money laundering hub | Transparency International UK

– over six times that of the US, with Transparency International's Director of Policy, Duncan Hames, describing the UK figure as "certainly, just the tip of the iceberg."[6]

A divergent global landscape

One potential reason the rate of UK real estate money laundering is so high is due to the lack of license or educational requirements. The UK, Spain, and Germany do not require licenses or education to sell real estate. In the US, real estate agents undergo a rigorous licensing exam. Similarly in Australia and many other countries, licensing and examinations are required. In France, one must obtain a bachelor's degree in real estate, while in Italy, the current requirements to take 80 hours of coursework or obtain a degree in accounting are under consideration to make entry requirements even tougher.

The picture diverges even more when considering the extent to which AML regulation applies to real estate. In the European Union, AML regulation is very limited in scope. In the USA, AML regulation applies partially, and there is a move to increase it with the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury, having issued various geographic targeting orders (GTOs)[7] aimed at identifying individuals attempting to hide their assets and identities in the real estate sector. In Australia, all real estate-related transactions are reported to the Australian Transactions Reports and Analysis Centre (AUSTRAC), a government financial intelligence agency, despite real estate not being regulated for AML in the country. This inconsistent global patchwork of real estate regulation, both in AML and generally, contributes yet further to making real estate a money launderers' delight, particularly considering the quagmire of international regulatory cooperation required for any enforcement.

In the UK, although policy on property sales is the responsibility of central government, policy on letting and management are entrusted to the home nations. Scotland and Wales have a regulatory regime for letting and managing agents, incorporating comprehensive education, fitness, and propriety requirements.

Property trade associations and their membership numbers

The Best Report, an independent report into the Regulation of Property Agents from 2019, brought into sharp relief the bewildering array of trade associations in the real estate industry, as this non-exhaustive table from the report shows:

Name	Specialism	Membership (approximate)[8]
ARLA Propertymark (Association of Residential Property Agents)	Letting agents - individuals	9,600 individuals
Association of Residential Managing Agents (ARMA)	Managing agents - firms	265 firms
Guild of Property Professionals (GPP)	Letting and sales agents – independent firms	800 firms
Institute of Residential Property Management (IRPM)	Managing agents - individuals	5,000 individuals
NAEA Propertymark (National Association of Estate Agents)	Sales agents - individuals	7,200 individuals
Royal Institution of Chartered Surveyors (RICS)	Letting, managing, and sales agents – firms and individuals	2,000 firms
Safeagent	Letting agents - firms	1,500 firms
UK Association of Letting Agents	Letting agents - firms	987 firms
Association of International Property Agents	Lettings and sales agents – firms (specialises in overseas lettings and sales)	370 firms

[6] ibid
[7] https://www.fincen.gov/news/news-releases/fincen-renews-and-expands-real-estate-geographic-targeting-orders
[8] Numbers in the final column reflect whether the primary form of membership is at individual or firm level (although many of the bodies above have a relationship at both levels) (footnote taken from the Best Report)

Yet, even given the wide choice of professional bodies, most real estate firms and individuals are not members of any.[9] There is also little or no support, even within the bodies themselves, for any such body becoming a regulator.

HMRC Insights

The team responsible for real estate AML supervision at HMRC, tasked primarily with tax collection but also with regulating a substantial portion of the market for AML, provides valuable insights into financial crime in the real estate market.

Money laundering in lettings

The first insight is that HMRC is hardly ever able to look at cash flows because estate agents don't get involved with them. They act as intermediaries, with the settlement money passing direct between clients' and buyers' bank accounts via solicitors' client accounts.

Second, UK money laundering regulations only apply to lettings of more than €10,000 per month, thereby excluding most of the lettings market. Third, unlike banking, there is no concept of structuring, such that several transactions just below the threshold are aggregated.

€10,000+

The monthly rental fee whereby UK money laundering regulations start to apply'

This is remarkable, but of course, HMRC is right. Letting agents have only been covered by the regulations since 2020, with the passing of The Money Laundering and Terrorist Financing (Amendment) Regulations 2019[10]. Additionally, the definition of 'letting agency work' is added to the 2017 regulations as

"work… done in a case where an agreement is concluded for the letting of land—

1. *for a term of a month or more, and*
2. *at a rent which during at least part of the term is, or is equivalent to, a monthly rent of 10,000 euros or more[11], and 'Letting Agents are defined as entities who carry out letting agency work, when carrying out such work' "[12] (emphasis added).*

The effect of all this, as pointed out by HMRC, is that the regulator is powerless to investigate anything that does not affect a rental of less than €10,000 per month. The team speaks wistfully about their Australian counterparties' access to data denied to them. The regulations also specifically state that customer due diligence (CDD) only needs to be performed in the case of such lettings. Personal experience and the experience of others suggest that letting agents do, in fact, conduct thorough CDD for all rentals, not least because of the need to verify that the tenant has the right to rent in the UK[13], a check that usually covers CDD procedures in such cases when they are mandatory, but the regulations make it clear that they are not obliged to do so.

The above limitations to AML regulation are in the fifth EU Money Laundering Directive[14] and are therefore Europe-wide unless any country chooses to make AML regulation more stringent. Few do.

The limitations on regulation of lettings are significant. Leading letting and estate agent Stirling Ackroyd estimates that £3 billion of clients' money is held by letting agents at any one time[15].

Professional bodies

Professional bodies for estate agents do exist, of course. Organisations such as Propertymark and the Royal Institute of Chartered Surveyors are among the largest, but their members only account for about 33% of the industry. See below for a more detailed analysis of these professional bodies. According to HMRC, the industry wants regulation. However, with some exceptions, such as Propertymark's recent paper (see below), no concrete steps seem to be being taken by the industry to achieve this.

[9] Derived from conversations with HMRC.
[10] SI 2019/1511, Regulation 4 (4) (b), amending Regulation 13 (2) of the 2017 Regulations
[11] Ibid
[12] Ibid
[13] Section 22, Immigration Act 2014
[14] Article 1, Directive (EU) 2018/843
[15] Stirling Ackroyd Estate Agents | What is Client Money Protection (CMP)?

Estate agency in prisons

One "headache" for HMRC is that estate agency is a very popular course in most prisons. The only power the team has to stop those convicted of crimes of dishonesty, violence, etc. from becoming estate agents is to prevent them from undertaking such business once released. This is usually circumvented by criminals' family members registering as the owners and managers as a front.

It is true that trade standards authorities can intervene to close estate agents in individual cases if they believe that dishonest or violent criminals are running estate agents,[16] but this power is only available retrospectively when a case comes to the authority's attention, rather than the barrier to entry that a licensing regime would constitute.

Enforcing the regulations

To the extent it does have jurisdiction, HMRC vigorously enforces the regulations. It has been noted in many industry journals that fines for money laundering regulation breaches are on the rise. MoneyAge, for example, reports in January 2023 that

> *"...the total fines in the first quarter of the financial year hit £304,023, equating to 44% of total fines seen in the previous financial year in just a single quarter"[17].*

Estate Agency Today adds in July 2023[18]:

> *"Since the introduction of AML supervision in 2017-18, estate agency businesses have been fined £2.5m in AML penalties. This ranks second across all supervised sectors, behind only money services businesses (£6.2m). What's more, when it comes to the number of individual fines issued by HMRC since 2017, estate agents have the worst record, the research found. The sector now accounts for 49.8% of the total 544 penalties issued across all sectors".*

Furthermore, when one considers the size of the fines, although they are substantially lower than in the banking sector, a calculation of the fine as a percentage of total assets of the entity fined reveals that the percentage is, on average, many times higher than in banking[19]. HMRC is also keen to point out that, unlike with some other regulators, there is no ceiling to fines imposed by HMRC and the regulator will not be shy of imposing yet higher penalties if considered appropriate.

> **"*There is no ceiling to fines imposed by HMRC***

However, several other tools in HMRC's regulatory toolkit may prove more effective than fines.

Firstly, HMRC publishes a list of firms who do not comply with the regulations[20]. The list includes details of the firm, its address, and details of the fine imposed and the breach. Whereas a large global bank may shrug off such publicity (and at least as much detail is available on the FCA Website), it hurts estate and letting agents far more:

- It is published on gov.uk – by definition, the most authoritative source in the UK.
- Estate agents and letting agents deal with the public. The overwhelming majority of members of the public, believing themselves to be honest people, choose to deal with entities that are not tainted by negative comment from the government.
- Whereas members of the public build relationships with their bankers, brokers, insurance companies, etc., this is much less the case with real estate arrangements, which tend to be far more infrequent. Therefore, the basis of selection is likely to be more influenced by negative authoritative public comment.

Secondly, as can again be seen from gov.uk, HMRC is not afraid to withdraw the registration of firms, on a temporary or permanent basis, if they are found to be sufficiently non-compliant.

[16] See Section 3 of the Estate Agents Act 1979
[17] Average AML fine issued to estate agents on the rise - Money Age
[18] Estate agency AML fines on the rise... (estateagenttoday.co.uk)
[19] Empirical research by the author
[20] Businesses that have not complied with the regulations (2022 to 2023) - GOV.UK (www.gov.uk)

Can We Fix It?...

The real estate industry, in the US and UK, is increasingly under regulatory scrutiny from an AML point of view.

In 2017, the UK government commissioned a report chaired by Lord Best on regulation of letting and managing agents. In an answer to a Parliamentary Question in May 2023, the Secretary of State for Levelling Up, Housing and Communities[21] stated that the government is still considering the Best Report and an announcement would follow.

The Best Report made several recommendations, including:

- Comprehensive regulation of estate agents (nationally), and letting and managing agents (in England) together with several other service providers such as auctioneers, rent-to-rent firms, property guardian providers, international agents, and online agents
- Initial exemption of property portals and short-term (holiday, etc.) lets but with statutory powers in the hands of a minister to extend regulation to these sectors by statutory instrument in the future.
- A comprehensive range of property related services that are illegal to offer without regulatory approval.
- An entry-level qualification of at least Level 3 of the Ofqual Regulated Qualification Framework

More recently, the UK introduced the Register of Overseas Entities[22] in August 2022, requiring all overseas entities owning property or land in the UK to register with Companies House, stating beneficial ownership and control details. The entry must be updated every year in a similar way to the Companies Acts Confirmation Statements, and such entities cannot raise financing in their properties, buy, sell, transfer, or lease them until the updates have been registered.

Currently, the UK Government is considering yet another major revamp of AML Regulations, following criticism in FATF's latest Mutual Evaluation Report[23], particularly in recognised professional bodies (RPBs). It is consulting on four options, with a paper to be published in Q4 2023:

1. Office for Professional Body Anti-Money Laundering (OPBAS)-plus. Continuing with the current structure, but with more powers for OPBAS – particularly in public criticism of RPBs and possible rulemaking functions
2. Consolidation of RPBs. Reducing the current number of RPBs from the current 22 to 6, or even 2.
3. One single professional services sector regulator. Reducing the RPBs down to one regulator and possibly moving some HMRC responsibilities to the new body –including the real estate sector
4. One regulatory body. Merging of all AML regulation, including that within the current purview of the FCA and HMRC, together with OPBAS and all the RPBs into one body.

Propertymark published a much bolder set of recommendations in July 2023[24] titled Reducing Economic Crime in the Property Sector. The proposals are many and varied and would constitute a major step forward in AML regulation in the UK. They include:

- Mandatory regulation of the real estate industry, adopting the Best Report proposals
- Greater public enforcement, with the proceeds of fines being invested in regulation.
- Links and information sharing between the real estate industry and related professionals such as solicitors and accountants.
- HMRC publishing Suspicious Activity Report (SAR) examples for education and training purposes.
- A standard SAR form for the property sector
- Abandoning the current €10,000 per month threshold for AML regulation, thereby making all lettings subject to Money Laundering Regulations
- Extending all AML requirements of financial institutions to the real estate industry

Propertymark's reasoning behind this last item is interesting. In addition to the general desirability of CDD and EDD[25] , the association observes that banks have recently tended to refuse real estate firms bank accounts as part of a de-risking process.

[21] Rachel Maclean, Minister of State, Department of Levelling Up, Housing and Communities Written questions and answers - Written questions, answers and statements - UK Parliament
[22] Register of Overseas Entities: where we are now - Companies House (blog.gov.uk)
[23] The United Kingdom's progress in strengthening measures to tackle money laundering and terrorist financing (fatf-gafi.org)
[24] Reducing-economic-crime-in-the-property-sector-position-paper.pdf (propertymark.co.uk)
[25] Customer Due Diligence and Extended Due Diligence

This makes it more difficult for such entities to comply with the legal requirement to segregate client money. Propertymark suggests that if the industry adopted the same standards of CDD and EDD as the banks themselves, this trend may be reversed.

US approach to regulation

Development of US AML regulation began in 1988 with the amendment of the Bank Secrecy Act (BSA) to cover "Persons involved in real estate closing and settlement". In 2017, FinCEN published an Advisory to Financial Institutions and Real Estate Firms and Professionals[26] and in 2021 worked with the National Association of Realtors to develop Voluntary AML Guidelines, published in 2022. It has also published various GTOs referred to above. However, in the words of the Congressional Research Service[27] in January 2022:

> *"...they are exempt under FinCEN rules from Money Laundering in the U.S. Real Estate Sector requirements to file Suspicious Activity Reports (SARs or Form 111) and Currency Transaction Reports (CTRs), and from maintaining a customer identification program (CIP) for AML recordkeeping purposes. Such persons remain exempt from establishing AML programs..."*

This is about to change. In December 2021, FinCEN issued an Advance Notice of Proposed Rulemaking (ANPRM)[28] outlining many possible expansions of BSA requirements with respect to real estate firms. The new rules will be published before the end of 2023.

Meanwhile, the KLEPTO Act[29] is making its way through the US Congress. This Act would, among other things, extend many of the current BSA requirements fully to real estate firms and require, for example, full disclosure of beneficial ownership behind corporate real estate buyers and require the US Treasury to consider Blockchain-like technology for recording all real estate transactions.

...Yes We Can?

Unfortunately, there is no quick fix. However, the industry appears to be moving, albeit slowly, in the right direction. Consolidation of regulatory bodies and regimes in both the USA and UK would appear to be a matter of priority, together with the adoption by the industry of the same standards and requirements by which banks currently operate. The ratification of proposals before governments in both countries would go a long way to achieve both.

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[26] FIN-2017-A003: FinCEN Advisory FIN-2017-A003, August 22, 2017
[27] Money Laundering in the U.S. Real Estate Sector - IF11967.pdf (fas.org)
[28] FinCEN Launches Regulatory Process for New Real Estate Sector Reporting Requirements to Curb Illicit Finance | FinCEN.gov
[29] S.4075 - 117th Congress (2021-2022): KLEPTO Act | Congress.gov | Library of Congress

About SymphonyAI Sensa-NetReveal

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