Market practice paper



Real Estate Transactions and AML Practice

[December 2023]

The Investment Association

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# Purpose

This document has been prepared for the benefit of the Investment Association’s membership, thereby covering a wide range of firm types and sizes. It is intended to inform, rather than prescribe. It is not binding, nor is it intended to be exhaustive, and firms will need to consider its application having regard to the nature, size and complexity of their business. Firms should also consider taking a risk based approach to the issues raised.

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# Introduction

The management of real estate by investment management firms is widely perceived to be one of the higher financial crime risks faced by firms. The impact of money laundering in the property sector is far reaching, with possible implications across many financial crime risks. Property can attract criminals for many reasons; it is widely available, can give illegitimate transactions legitimacy and provide avenues to conceal large sums of illicit funds, either through purchases and sales or rental income. Further, property prices tend to remain fairly stable and appreciate over time, during which money can be generated by leasing out the property. This is further amplified given that, on the whole, fewer checks are carried out in real estate transactions than other areas of the financial sector.

It is noted that the JMLSG Guidance has only two paragraphs on real estate, in Chapter 9 of Part II, on ‘Discretionary and advisory investment management’:

9.39 Some portfolios will include direct holdings in real assets\*. Unlike securities, the counterparties[[1]](#footnote-2) involved in the purchase and sale of direct holdings may not be other regulated financial institutions. Those purchases and sales will often involve special purpose vehicles, and in some cases will be owned via trusts and a wide variety of structures in a wide variety of jurisdictions which by their nature may increase the risk of coming into contact with the proceeds of crime.

 Some portfolios will make direct investments in construction and development projects. The nature of these projects, and especially the risks of fraud, bribery and corruption and tax evasion may also increase the likelihood of coming into contact with the proceeds of crime.

40 The counterparty(s) would not normally be regarded as a customer of the investment firm and consequently the firm would not be obliged to verify the identity of the counterparty(s) itself. Nevertheless, and as part of their risk-based approach, the investment firm may take account of the risk profile of the transaction and of the counterparty(s) involved. This may include reviewing the nature of the transaction, ascertaining the counterparty’s legal form (taking into account the jurisdiction in which the counterparty(s) is based and whether or not it is a regulated financial institution within another equivalently regulated jurisdiction), checking for adverse information, PEPs and sanctions-related screening (prior to execution and thereafter on an ongoing basis).

\* Note: *Real assets is an investment asset class that covers investments in physical assets such as real estate, energy, and infrastructure*.

Many Government bodies hold property, creating political involvement (e.g. [NAMA](https://www.nama.ie/) in Ireland). Conflicts of interest arise from the relationship between: partners and investors in real estate; banks or similar entities set up to hold bad debt; and planning authorities. There are also Gifts and Hospitality (G&H) and inducements issues. As noted in the JMLSG Guidance, while some firms are regulated, many of the counterparties they interact with are unregulated. Property deals also often involve multi-million pound deals and SPVs.

It should be noted that the Money Laundering Regulations 2017 are silent in relation to real estate transactions. They do, however, apply to financial institutions and legal professionals (as well as to estate agents) acting ‘in the course of business’. They also apply to solicitors when participating in real estate transactions.

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# Identification of purchaser and vendor

The purchaser or vendor will have a relationship with the firm, with the nature of this relationship being determined by whether the purchaser or vendor has an existing business relationship with that firm (in which case ongoing monitoring obligations will already apply to that business relationship). Where no such existing business relationship exists, the purchaser or vendor must be subject to customer due diligence measures as the transaction will be considered an occasional transaction under Regulation 27 of MLR 2017.

For business relationship / occasional transaction with non-UK entity(s) that involve the purchase, sale or transfer of physical UK land or property (e.g., within a Real Estate Fund), investment management firms must obtain an excerpt of the Register of Overseas Entities from UK Companies House. Should the investment management firm identify a material discrepancy between the beneficial ownership information collected as part of its CDD process and the registrable beneficial ownership information held at UK Companies House, the discrepancy must be reported to UK Companies House as soon as possible.

## Purchaser

* Examples of purchasers e.g. individuals, private companies (including trusts), regulated entities, funds. An example would be where a fund is selling a real estate property from a portfolio owned on behalf of a client to a third party.
* Regulations applying directly to purchasers, such as MLR 2017
* Completion of due diligence to an appropriate level based on the risk of financial crime
* Other issues specific to the transaction, e.g. criminal allegations found via open-source searches
* Identification and mitigation of specific Financial Crime risks by way of appropriate due diligence covering source of wealth, source of funds, transparency/complex ownership structures, adverse media, high risk jurisdictions, sanctions, presence of PEPs, etc.

## Vendor

* The vendor is the person selling the real estate to an investment firm
* Regulations applying directly to vendors
* Obligations and/or exemptions that apply to vendors
* Other specific issues, e.g., criminal allegations found via open-source searches
* Completion of due diligence proportionate to the level of Financial Crime risk
* Identification of any specific Financial Crime risks, such as lack of transparency, complex ownership structures, adverse media, high risk jurisdictions, sanctions, presence of PEPs, etc.

# Other Counterparties

The term counterparty(s) reflects the involvement of other third parties in the sale or purchase of a piece of real estate e.g., chartered surveyors, agents etc. and should not be confused with the purchaser or vendor of the real estate who will be considered the customer of the investment management firm either as part of an ongoing business relationship or via an occasional transaction.

* Firms should understand the role of these various parties to the Real Estate Transaction (including if they have control over any flow of money)
* Firms should understand whether the counterparty or related party is involved on a one-off basis or whether it will be ongoing after completion of the transaction
* Firms should ensure that any agreed payment to these counterparties is aligned to the market rate and fully documented via a contract/legal agreement
* Firms should ensure that adequate Financial Crime clauses are included in any legal agreement to hold the relevant parties accountable for providing all required information to allow for the completion of due diligence requirements, which may include payment screening against applicable sanctions lists.
* Completion of due diligence proportionate to the level of Financial Crime risk. For on-going relationships, this shall include on-going due diligence at defined intervals
* Specific Financial Crime risks, such as lack of transparency, complex ownership structures, adverse media, high risk jurisdictions, sanctions, presence of PEPs, etc.
* Investment agents etc.

## TENANTS

* Regulations applying directly to landlords, such as MLR 2017
* Completion of due diligence on the tenants (and guarantor, if one exists) proportionate to the level of Financial Crime risk and in line with the financial thresholds (CSSF requires DD on all tenancy agreements longer than one month, with a monthly rental value exceeding 10,000 EUR)
* For properties with existing tenants, perform an assessment of due diligence undertaken by the current landlord.
* Completion of due diligence on property managers.
* Ensuring that there is a legal agreement/contract in place between the tenant/landlord and landlord/property manager (which includes Financial Crime clauses and what the obligations of each party are).
* Firms are not required to carry out due diligence on tenants unless they have a direct agreement with the Fund, in which case it is recommended to treat them as counterparties and apply similar rules.
* Nonetheless, unless a paying agent / real estate broker confirms that they perform the screening on the tenants, firms may wish to screen any tenants representing a substantial rental revenue (e.g. 25% of the total rental revenue for Low/Medium risk – 10% for the high-risk cases)
* The highest financial crime risk of a tenant relationship is not onboarding them, but monitoring what it is they do with the property and how they generate the income to pay for the tenancy agreement.
* Identification and appropriate escalation of suspicious activity is an absolute requirement.

## AUCTIONS

Regulations applying directly to vendors, such as MLR 2017

* Completion of due diligence (on the auction house/auctioneer) should be proportionate to the level of Financial Crime risk
* Ensuring that there is a legal agreement/contract in place between the buyer/seller and the auctioneer, which includes Financial Crime clauses and what the obligations of each party are – including that the transaction is not final until all parties are satisfied with the level of due diligence completed and that this doesn’t put them at unnecessary risk of financial crime

# Infrastructure

* Investment transactions to build infrastructure, or lending to fund the building of infrastructure, should take into account the risk associated with the construction industry. Specifications, tendering arrangements, architects’ instructions, specialists’ reports, stock and payments can all be manipulated for the purposes of fraud. The high level of regulation and approvals required, also make this an area where bribery and corruption can occur regularly.
* Many Infrastructure projects have public sector involvement. This can help to reduce financial crime risk as public authorities and public officials, and the nature and purpose of their business are straightforward to identify and verify. On the other hand, dealing with public authorities means a higher likelihood of dealing with entities under the control of politically exposed persons (PEPs) and therefore, a greater risk of public sector corruption when dealing with public authorities in high risk jurisdictions with opaque anti-corruption regimes, and being used as vehicles for the laundering of proceeds of crime, and therefore a need to ensure that public funds are being used correctly. Dealing with State-Owned Companies (SOCs) based in higher risk jurisdictions can pose similar risks as dealing with PEPs.
* Infrastructure projects can be made of special purpose vehicles with complex ownership structures. Although there are often good reasons for this, it is important to understand the ownership structure right back to the ultimate beneficial owner. SPVs, trusts and foundations are often necessary investment vehicles, but they are not transparent: this means that they can be abused to hide the true identity of the owner and the origin of their money.
* Some infrastructure investment transactions are one-off purchases and/or sales of companies or debt. Due Diligence should be carried out on the vendor/purchaser as it is incumbent on firms to ensure that they do not accept the proceeds of crime as payment for an asset, but also do not purchase an asset which was obtained by the vendor with proceeds of crime.
* One of the strategies used is to bring co-investors into transactions alongside the internal client. It is important that co-investors are subject to due diligence as per a counterparty, to ensure the firm understands who it is dealing with. Completing risk based due diligence on investors is normally the responsibility of business development teams, however, in some instances, infrastructure investment teams may be involved in the process.

The different types of infrastructure investments that firms manage raise different levels of inherent financial crime risk, which depend on the type of relationships with the investment:

* In one-off purchases and sales, whether for equity or secondary debt investments, due diligence on the vendor or the purchaser, i.e. “One-off counterparty” and their beneficial owners should be performed.
* In longer term relationships, e.g. with borrowers, tenants, or other providers of income, risk based ongoing monitoring obligations should be undertaken.
* Risk-based Financial Crime due diligence is also performed on service suppliers, contractors, developers and other suppliers, “Third Parties”, which are contracting, on a one-off or on-going basis, with the firm-managed infrastructure entities.

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| **Counterparties** – parties with which there is a one-off or ongoing contractual relationship to the ownership of the investment asset, and the long term income from the asset | **Examples** |
| One-off Counterparties | Vendors, like banks or project developers |
|  | Purchasers |
| On-going Counterparties | Borrowers |
|  | [[2]](#footnote-3)Tenants |
|  | Companies invested in, but not controlled by, the firm |
|  | Co-Investors – joint owners or partners in investment transactions |

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| **Third Parties** – other parties for which there is a contractual relationship in relation to the investment |  |
| Construction management and EPC contractors | On-going equipment Suppliers |
| Operations and Maintenance providers | Manufacturers |
| Project Managers, Asset Managers | Advisers or Consultants |
| Insurance service providers | Accountant, administration services, Depositaries |

The firm should review the Initial Consideration Form and other information and will need to establish all relationships on which due diligence will be required and these will include the following as appropriate:

* One–off counterparties
* Long term counterparty
* Third Parties

# Annex

## Sources that may be useful

* MLRs: [The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017](https://www.legislation.gov.uk/uksi/2017/692)
* FCA Rules
* JMLSG [Guidance](https://www.jmlsg.org.uk/guidance/current-guidance/)
* [HMRC](https://www.gov.uk/guidance/registration-guide-for-estate-agency-businesses) Guidance designed for estate agency and property-related businesses: [AML Supervision for Estate Agency and Letting Agency Business](https://www.gov.uk/government/publications/money-laundering-regulations-2007-supervision-of-estate-agency-businesses): <https://www.gov.uk/government/publications/money-laundering-regulations-2007-supervision-of-estate-agency-businesses>
* RICS [reminder](https://www.rics.org/news-insights/money-laundering--reminder-to-members-and-firms) to members and firms
* NECC Understanding how the property market is used to facilitate money laundering – April 2023
* Kroll – [AML Due Diligence](https://www.kroll.com/en/services/compliance-risk-and-diligence/screening-and-due-diligence/aml-compliance-due-diligence)
* Dun & Bradstreet: [Regulatory Compliance and Financial Crime](https://www.dnb.co.uk/solutions/regulatory-compliance-financial-crime.html)
* ICIJ – [Offshore Leaks Database](https://offshoreleaks.icij.org/), includes the Panama Papers, Pandora Paper, Paradise Papers etc.
* AREF position paper on the use of non-UK domiciles for funds – AREF members only
* FATF
	+ [Report on](https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf) Money Laundering and Terrorist Financing Through the Real Estate Sector
	+ [Recommendations](https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf) – particularly referenced in Recommendation 22(b), (d)
	+ [Risk-based Approach Guidance](https://www.fatf-gafi.org/content/fatf-gafi/en/publications/Fatfrecommendations/Guidance-rba-real-estate-sector.html) for the Real Estate Sector
1. The term counterparty(s) reflects the involvement of other third parties in the sale or purchase of a piece of real estate e.g., chartered surveyors, agents etc. and should not be confused with the purchaser / vendor of the real estate who will be considered the customer of the investment management firm either as part of an ongoing business relationship or via an occasional transaction. [↑](#footnote-ref-2)
2. Firms’ responsibilities will depend on how they are arranged. The tenant relationship may be managed by an agent, with whom firms will have a vendor relationship. Estate Agents are now subject to the MLRs, and firms may wish to ensure that they are aware of their obligations. [↑](#footnote-ref-3)