



Financial Action Task Force

Groupe d'action financière

**MONEY LAUNDERING & TERRORIST
FINANCING THROUGH THE REAL ESTATE
SECTOR**

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EXECUTIVE SUMMARY

1. Various reports produced by the FATF over the last few years have made reference to the fact that the real-estate sector may be one of the many vehicles used by criminal organisations to launder their illicitly obtained money.¹ The general objective of this report is to develop more information on this issue and present a clearer picture of the way that real estate activity can be used for money laundering or terrorist financing.

2. The study aims to accomplish two primary goals: First, it explores the means by which illicit money is channelled through the real-estate sector to be integrated into the legal economy. Second, it identifies some of the control points that could assist in combating this phenomenon. One of the most effective ways to understand how the sector is abused is to examine concrete case studies; therefore, the report is based primarily on information provided by participating FATF and non-FATF members.

3. Several characteristics of the real estate sector make it attractive for potential misuse by money launderers or terrorist financiers. The report outlines the reasons for this. From the case examples provided during the research for this project, several basic techniques were identified, such as the use of complex loans or credit finance, the use of non-financial professionals, the use of corporate vehicles and so on. The report briefly describes these techniques, followed by one or more most striking case examples. To reach out to the private sector, part of the research has been to develop a basic list of risk indicators from the case examples. These indicators may assist financial institutions and others involved in certain types of real estate activities in customer due diligence and in performing a risk analyses on new and existing clients.

4. The project identified three areas that seem especially vulnerable for misuse in money laundering schemes involving real estate and thus suitable for further consideration. In almost all case examples provided, wire transfers to channel the money have been involved at some stage. Also emerging markets seem to be more vulnerable to misuse of the real estate sector. Due to the worldwide market growth of real estate-backed securities and the development of property investment funds, the range of options for real estate investments has also grown. This effect has not gone without notice in emerging markets. Money laundering transactions can be easily camouflaged in genuine commercial transactions among the huge number of real estate transactions taking place. Complicating matter is the fact that often these less developed economies do not have an average market price for real estate, but rather prices varying across sectors and districts. To complete real estate transactions in some stage of the process involvement of legal expert is inevitable. The case examples have shown this category, when not covered by AML/CFT obligations, often becomes the weakest link in the process.

¹ This report is the product of research carried out by a project team operating under the umbrella of the FATF typologies initiative. The FATF project team was led by Spain and the Netherlands with the participation of Australia, Belgium, Canada, Japan, Lebanon, Luxembourg, Mexico, Myanmar, Norway, Pakistan, Portugal, South Africa, South Korea, Sweden, Ukraine, the United Kingdom, the United States, Interpol, the European Central Bank, and the OECD.

INTRODUCTION: NATURE OF THE REAL-ESTATE SECTOR

5. The real estate sector merits closer consideration given the large scope of monetary transactions, its significant social impact, and because of the number of cases in which money laundering, and in limited circumstances terrorist financing and tax fraud schemes, have been detected.² Abuse in this sector also has the undesirable effect of political, institutional and economic destabilisation. Moreover, due to the international nature of the real-estate market, it is often extremely difficult to identify real estate transactions associated with money laundering or terrorist financing.

6. Given that the purchase or sale of a property is one of the largest financial transactions a family or individual may undertake, changes in property prices have a substantial impact on the considerations taken into account by potential buyers and sellers of properties. Fluctuations in property prices have an impact on decisions about where to live and work in addition to affecting an owner's net worth. Moreover, to the extent that property values influence rents, the effect is manifested in the distribution of wealth between landlords and tenants. Finally, property prices significantly influence the building industry. Taken together, these factors all suggest that fluctuations in property prices may influence economic activity and price stability by affecting aggregate supply and demand, the distribution of income, and the debt decisions undertaken by households.³

7. Nevertheless, it is difficult to monitor and explain variations in property prices due to a lack of reliable and uniform information. Property markets are geographically segmented and numerous factors shape the local price of real-estate. Understanding the factors that underlie pricing in the property market is therefore essential.

8. Historically there exists a commercial and residential real-estate market, and the property in both types of market may be bought and sold, managed and/or developed. More recently, new investment vehicles have emerged, including *property investment funds* (PIF) and *real estate investment trusts* (REIT). Such instruments allow average citizens to invest in markets – historically only available to the very wealthy – in order to create a diversified portfolio.

9. Investment in the real-estate sector offers advantages both for law-abiding citizens and for those who would misuse the sector for criminal purposes. Real property has historically appreciated in value, and many countries offer incentives to buyers, including government subsidies and tax reduction. Most importantly for misuse by criminals, however, is the facility the sector may provide for obscuring the true source of the funds and the identity of the (ultimate) beneficial owner of the real asset, which are two key elements of the money laundering process.

10. The real-estate sector is therefore of extraordinary importance to the economy in general and the financial system in particular. The widespread use of mechanisms allowing households to access the property market, the elimination of personal limitations on property ownership, the economic development and growth of tourism in many regions have all led to exponential growth in the number

² It is important to note as is mention by the OECD (Sub-group on Tax Crimes and Money Laundering) in its real estate report that in many countries, their tax authorities investigate these cases in partnership with other law enforcement agencies. In some instances, parallel investigations for tax fraud and money laundering may be pursued. The OECD examined tax fraud and money laundering involving the real estate sector, along with identity theft and identity fraud. It also developed a training manual to assist tax auditors in detecting and reporting cases of suspected money laundering and/or terrorist financing. The confidential report contains: the scope and nature of the issue, how cases are successfully detected and investigated, a list of red flag indicators (catalogue), the benefits of multi-agency co-operation (including effective exchange of information), compliance results and risk prevention strategies and an inventory of relevant case studies.

³ European Central Bank (2006).

of financial transactions linked to real-estate. The extraordinary range of possibilities for misusing these processes also allows suspected criminals to integrate and enjoy illegally obtained funds.

11. Through the implementation of international standards in recent years, countries have put various measures into place within their formal financial sector – which includes, among others, banks and credit unions – in order to prevent money laundering and terrorist financing. Because of the tendency for illegal activity to move to other financial / economic areas that may have less formal oversight or where there is relatively less potential for detection, countries must consider extending AML/CFT measures to other parts of their economies, if they want to respond successfully to this threat. For the real-estate sector, this would necessarily include such key players as real-estate agents, legal advisors and notaries.

BASIC TECHNIQUES

12. In order to misuse the real-estate sector, a number of methods, techniques, mechanisms, and instruments⁴ are available. Many of these methods are in and of themselves illegal acts; however, certain of them might be considered perfectly legal if they were not associated with a money laundering or terrorist financing scheme (or if this association could not be detected. Through examination of case examples from past money laundering and terrorist financing cases, this study has identified a series of the more common or basic methods and then grouped them according to type or “typology”.

- Use of complex loans or credit finance.
- Use of non-financial professionals.
- Use of corporate vehicles.
- Manipulation of the appraisal or valuation of a property.
- Use of monetary instruments.
- Use of mortgage schemes.
- Use of investment schemes and financial institutions.
- Use of properties to conceal money generated by illegal activities.

Typology 1: Complex Loans and Credit Finance

13. Intercompany loans have become a frequent instrument used as a means for raising funds. The ease with which such loans can be arranged makes them popular with the general public. These loans are also used in the real estate sector. Where an instrument is frequently used, misuse of the instrument becomes a possibility as well. Depending on the way in which the loan is structured, two different schemes have been detected.

Loan-Back Schemes

14. Intelligence and law enforcement reports indicate “loan-back” transactions are used by suspected criminals to buy properties – either directly or indirectly – through the purchase of shares in property investment funds. Essentially, suspected criminals lend themselves money, creating the appearance that the funds are legitimate and thus are derived from a real business activity. The purpose of the loan is to give the source of the money an appearance of legitimacy and to hide the true identity of the parties in the transaction or the real nature of the financial transactions associated with it.⁵

⁴ This report uses the terminology commonly used by the FATF in its various projects. See Annex A to this report and FATF (2005) for more on this terminology.

⁵ The lack of information caused by the internationalisation of these structures and their specific morphology make it difficult to understand the true relationship between the various corporate vehicles involved in the loan structure and to be sure of the real origin of the funds, and thus determine whether they are linked to criminal activities or not. In several cases, offshore company loans were used. See FATF (2006) for more on the use of legal persons for money laundering.

Case study 1.1: Proceeds of drug trafficking laundered into real estate

(Predicate offence: money laundering forged loan agreement)

An individual set up three companies. For one of the companies he held bearer shares. To hide his involvement in the companies he used a front-man and a trust and company service provider⁶ as legal representatives. For each of the companies, the legal representatives opened bank accounts with three different banks in different jurisdictions. The individual used the three companies to set up a loan-back scheme in order to transfer, layer and integrate his criminal money. He then co-mingled the criminal funds with the funds that originated from the legal activities of one of his companies.

Next the front man then bought real estate. To finance that transaction he arranged for a loan between the two companies.

A more detailed version of this scheme (describing all steps in the process) is included in Annex C.

Indicators and methods identified in the scheme:

- **The source of the funds used to finance the real estate transaction was from abroad, in particular from offshore jurisdictions and jurisdictions with strict bank secrecy.**
- **The lender of the money, an offshore company, had no direct relation with the borrower of the money**
- **A financial institution was not involved in the loan structure.**
- **There was no loan agreement between the lender and borrower.**
- **The loan agreement was legally invalid.**
- **The information in the loan agreement was inconsistent or incorrect.**
- **The conditions in the loan agreement were unusual (for example, no collateral was required).**
- **No payment of interest or repayment of the principal.**
- **Transaction monitoring by financial institutions showed payable-through accounts, by which incoming payments from abroad were immediately transferred abroad without a logical reason.**

Source: Netherlands.

Back-to-Back Loan Schemes

15. As with *loan-back* schemes, *back-to-back loans* are also known to be used in real-estate related money laundering schemes. In this case, a financial institution lends money based on the existence of collateral posted by the borrower in the usual way. However, the collateral presented to the financial institution originates from criminal or terrorist activities. Although financial institutions are obligated to disclose the existence of these funds on a risk dossier, there are occasions where this analysis may contain shortcomings. Instances where the collateral posted is not specified in the loan agreement or unreliable information as to the nature, location and value of the collateral make it very difficult to recognise a back-to-back loan.

Case study 1.2: Back-to-back loan used to launder funds

(Predicate offence: forged loan agreement, in particular the failure to mention the security underlying the loan and money laundering)

An individual set up two companies in different jurisdictions. He used a front man and a trust and company service provider as legal representatives to hide his involvement. One of the companies, led by the front-man, owned real estate and generated income through rental activity. He set up a back-to-back loan structure to use his criminal money for his real estate investments. He then arranged a bank guarantee between two banks in case of a default of the loan. The bank was willing to provide the bank guarantee with the pledged deposit of one of his companies as collateral. The money placed as a deposit was generated by the individual's criminal activity.

A more detailed version of this scheme (describing all steps in the process) is included in Annex C.

Indicators and methods identified in the scheme:

- **No reference in the loan agreement to the underlying collateral.**

⁶ See Annex A for definitions of this term and others used in this report.

- **The collateral provided was not sufficient**
- **The collateral provider and other parties involved in the loan structure were not known.**
- **The borrower of the money was not willing to provide information on the identity and background of the collateral provider and/or the other parties involved in the loan structure.**
- **The complex nature of the loan scheme could not be justified**
- **There was an unexpected loan default.**

Source: Netherlands.

Typology 2: The Role of Non-Financial Professionals

16. Research has shown that when governments take action against certain methods of money laundering, criminal activities tend to migrate to other methods. In part, this reflects the fact that more aggressive policy actions and enforcement measures increase the risk of detection and therefore raise the economic cost of using these methods.

17. FATF experts have observed in recent years that money launderers are increasingly forced to develop elaborate schemes to work around AML/CFT controls. This has often meant seeking out the experience of professionals such as lawyers, tax advisors, accountants, financial advisors, notaries and registrars in order to create the structures needed to move illicit funds unnoticed. These professionals act as *gatekeepers* by providing access to the international financial system, and knowingly or not, can also facilitate concealment of the true origin of funds.⁷

Obtaining Access to Financial Institutions Through Gatekeepers

18. A number of cases reveal that criminals and terrorists have used non-financial professionals or gatekeepers to access financial institutions. This is especially important during the process of determining eligibility for a mortgage, opening bank accounts, and contracting other financial products, to give the deal greater credibility. It has also been documented that bank accounts are opened in the name of non-financial professionals in order to carry out various financial transactions on their behalf. Examples include depositing cash, issuing and cashing cheques, sending and receiving international fund transfers, etc., directly through traditional saving accounts or indirectly through correspondent accounts.⁸

Case study 2.1: Misuse of a real estate agent to gain introduction to a financial institution, possible link to terrorist financing

(Predicate offence: suspected terrorist financing)

A trustee for a trust established in an offshore centre approached a real estate agent to buy a property in Belgium.

The real-estate agent made inquiries with the bank to ask whether a loan could be granted. The bank refused the application, as the use of a trust and a non-financial professional appeared to be deliberately done to disguise the identity of the beneficial owner. The bank submitted a suspicious transaction report.

Following the analysis of the financial intelligence unit, one of the members of the board of the trust was found to be related to a bank with suspected links to a terrorist organisation.

Indicators and methods identified in the scheme:

- **Instrument: real estate, loan.**
- **Mechanisms: bank, trust, real-estate agent.**

⁷ FATF (2001), p. 12.

⁸ Although it is not the scope of the report, the FATF experts have observed the misuse of the correspondent accounts as a way to hide the origin or destination of money flows and the real participants in the transaction. On several occasions, the misuse of these accounts has been linked to the type of operations reflected in it, especially when cheques or cover payments were used.

- **Techniques: offshore customer, non-account holder customer, physical person intermediary, high risk jurisdiction, loan, purchase of real estate.**
- **Opportunity taken: using a trust and appealing to a non-financial profession was clearly done to disguise the identity of the beneficial owner.**

Source: Belgium, 2003.

Assistance in the Purchase or Sale of Property

19. Non-financial professionals such as notaries, registrars, real-estate agents, etc., are sometimes used by suspected criminals on account of their central role in carrying out real-estate transactions. Their professional roles often involve them in a range of tasks that place them in an ideal position to detect signs of money laundering or terrorist financing.

20. Until relatively recently, however, these professionals have not been obligated under international standards to report suspicious activity to their national financial intelligence units (FIUs). In some countries where non-designated financial professionals fall under the scope of anti-money laundering legislation, these systems are still in the initial stages of implementation⁹, so that the level of co-operation and the effectiveness of their suspicious transaction reporting have not yet been extensively tested. Operational problems have also arisen. In some cases, these have resulted from difficulties in centralising information gathered from various domestic authorities, and in others it stems from differences in legal systems between jurisdictions (common law and civil law, for example).

21. Several cases have come to light revealing that the role of non-financial professionals in detecting illegal activity can also be significant in this area. There have been examples of notaries and registrars detecting irregularities in the signing of the property transfer documents (for example, using different names or insisting on paying a substantial part of the cost of the transaction in cash). Other examples include buying land designated as residential through a legal person and then reclassifying it a short time later for commercial development. Professionals working with the real-estate sector are therefore in a position to be key players in the detection of schemes that use the sector to conceal the true source, ownership, location or control of funds generated illegally, as well as the companies involved in such transactions.

Case study 2.2: Use of a notary when buying a real estate

(Predicate offence: suspected money laundering by organised crime)

An East European was acting under a cover name as the director of a company for which he opened an account with a Belgian bank. Transfers were made to this account from abroad, including some on the instructions of "one of our clients".

The funds were then used to issue a cheque to a notary for the purchase of a property. The attention of the notary was drawn to the fact that some time after the purchase, the company went into voluntary liquidation, and the person concerned bought the property back from his company for an amount considerably above the original price. In this way the individual was able to insert money into the financial system for an amount corresponding to the initial sale price plus the capital gain. He was thus able to use a business account, front company customer, purchase of real estate, cross border transaction and wire transfers to launder money that, according to police sources, came from activities related to organised crime.

It appeared that the company acted as a front set up merely for the purpose of carrying out the property transaction.

Indicators and methods identified in the scheme:

- **Instruments: check, wire transfers, real estate.**

⁹ In some countries the sector contains a large group of supervised natural and legal persons. That may be the cause for concerns regarding the capacity to provide adequate supervision.

- **Mechanisms:** notary, bank.
- **Techniques:** business account, front company customer, purchase of real estate, cross border transaction, incoming wire transfer, reverse/flip real estate, unknown source.
- **Opportunity taken:** use of a notary when buying a real estate. Since the company's bank account was not used for any other transaction, it can be deduced that this company was a front company set up for the mere purpose of carrying out the property transaction.

Source: Belgium, 2003.

Trust Accounts

22. A *trust account*¹⁰ is a separate bank account, which a third party holds on behalf of the two parties involved in a transaction. Funds are held by the trustee until appropriate instructions are received or until certain obligations have been fulfilled. A trust account can be used during the sale of a house, for example. If there are any conditions related to the sale, such as an inspection, the buyer and seller may agree to use a trust account. In this case, the buyer would deposit the amount due in a trust account managed by, or in the custody of, a third party. This guarantees the seller that the buyer is able to make the payment. Once all the conditions for the sale have been met, the trustee transfers the money to the seller and the title to the property is passed to the buyer.

Case study 2.3: Use of a solicitor to perform financial transactions

(Predicate offence: distribution of narcotics)

An investigation of an individual revealed that a solicitor acting on his behalf was heavily involved in money laundering through property and other transactions.

The solicitor organised conveyancing for the purchase of residential property and carried out structured transactions in an attempt to avoid detection. The solicitor established trust accounts for the individual under investigation and ensured that structured payments were used to purchase properties and pay off mortgages.

Some properties were ostensibly purchased for relatives of the individual even though the solicitor had no dealings with them. The solicitor also advised the individual on shares he should buy and received structured payments into his trust account for payment.

Indicators and methods identified in the scheme:

- **Instruments:** cash deposits, real estate.
- **Mechanisms:** solicitor, trust accounts.
- **Techniques:** structured cash transactions, establishment of trust accounts to purchase properties and pay off mortgages, purchase of property in the names of the main target.
- **Opportunity taken:** the solicitor set up trust accounts on behalf of the target and organised for transactions to purchase the property, pay off mortgages, and shares were purchased to avoid detection. In some cases properties were purchased in the names of relatives of the target.

Source: Australia.

Management or Administration of Companies

23. There have been documented cases of non-financial professionals approached by money launderers and terrorists not just to create legal structures, but also to manage or administer these companies. In this context, these professionals may have been generally aware that they are taking an active role in a money laundering operation. Their access to the companies' financial data and their direct role in performing financial transactions on behalf of their clients make it almost impossible to accept that they were not aware of their involvement.

¹⁰ Also known as an *escrow* account.

Case study 2.4: Abuse of a notary's client account

(Predicate offence: suspected trafficking in narcotics)

A company purchased property by using a notary's client account. Apart from a considerable number of cheques that were regularly cashed or issued, which were at first sight linked to the notary's professional activities, there were also various transfers from the company to his account.

By using the company and the notary's client account, money was laundered by investing in real estate in Belgium, and the links between the individual and the company were concealed in order to avoid suspicions.

Police sources revealed that the sole shareholder of this company was a known drug trafficker.

Indicators and methods identified in the scheme:

- **Instruments: cheque, cash, wire transfers, real estate.**
- **Mechanisms: notary, bank.**
- **Techniques: intermediary account, purchase of real estate, incoming wire transfer.**
- **Opportunity taken: by using the company and the notary's client account money was laundered by investing in real estate in Belgium, and the links between the individual and the company were concealed in order to avoid suspicions**

Source: *Belgium, 2002.*

Typology 3: Corporate Vehicles

24. Corporate vehicles – that is, legal persons of all types and various legal arrangements (trusts, for example)¹¹ – have often been found to be misused in order to hide the ownership, purpose, activities and financing related to criminal activity. Indeed that practice is so common that it almost appears to be ubiquitous in money laundering cases. The misuse of these entities seem to be most acute in tax havens, free-trade areas and jurisdictions with a strong reputation for banking secrecy; however, it may occur wherever the opacity of corporate vehicles can be exploited.

25. Apart from obscuring the identities of the beneficial owners of an asset or the origin and destination of funds, these corporate vehicles are also sometimes used in criminal schemes as a source of legal income. In addition to shell companies, there are other specialised companies that carry out perfectly legitimate business relating to real estate, which have sometimes been misused for money laundering purposes. This aspect is illustrated by the use, for example, of property management or construction companies. The use of corporate vehicles is further facilitated if the company is entirely controlled or owned by criminals.

*Offshore Companies*¹²

26. Legal persons formed and incorporated in one jurisdictions, but actually used by persons in another jurisdiction without control or administration of a natural or legal resident person and not subject to supervision, can be easily misused in money laundering transactions. The possibilities for identifying the beneficial owner or the origin and destination of the money are at times limited. In these scenarios actors with wrongful intentions have the distinct advantage of extra protection in the form of bank secrecy.

¹¹ See Annex A for definitions of some of these terms.

¹² It applies to the situation where a company is incorporated in one jurisdiction for persons who are resident in another jurisdiction. See FATF (2006) for the terminology relating to offshore companies.

Case study 3.1: Use of an offshore company to buy real estate.

(Predicate offence: suspected violations related to the state of bankruptcy)

A bank reported a person whose account had remained inactive for a long period but which suddenly was inundated with various cash deposits and international transfers. These funds were then used to write a cheque to the order of a notary for the purchase of a real estate.

It appeared that the party involved had connections with a company in insolvency and acted in this way to be able to buy the property with a view to evading his creditors.

The final buyer of the real estate was not the natural person involved but an offshore company. The party involved had first bought the property in his own name and subsequently had passed it on to the aforementioned company.

Indicators and methods identified in the scheme:

- **Instrument: cash, wire transfers, real estate.**
- **Mechanisms: notary, bank.**
- **Techniques: personal account, purchase of real estate, incoming wire transfer, dormant account, offshore transactions.**
- **Opportunity taken: use of an offshore company to buy real estate. It appeared that the party involved had connections with a company in insolvency and acted in this way to be able to buy the property with a view to getting away from his creditors.**

Source: Belgium, 2002.

Legal Arrangements

27. The use of some legal arrangements such as trusts can play an important role in money laundering. Under certain conditions these legal arrangements can conceal the identity of the true beneficiary in addition to the source and/or destination of the money.

28. The nature and/or structure of certain trusts can result in a lack of transparency and so allow them to be misused:¹³

- Certain trusts may exist without the need for a written document constituting them.
- Although there may be a deed defining the trust, in some cases it does not need to identify the depositary and/or a specific beneficiary.
- There may be no obligation to register decisions regarding the management of a trust, and it may not be possible to disclose them in writing to anyone.
- In some types of trust, such as discretionary trusts, the beneficiary may be named or changed at any time, which makes it possible to safeguard the identity of the beneficiary at all times up until the moment the ownership of the assets is transferred.
- Trusts set up to protect assets may protect the depositary against decisions to freeze, seize or attach those assets.
- Trusts may be set up to manage a company's shares, and they may make it more difficult to determine the identities of the true beneficiaries of the assets managed by the trusts.
- Certain legislation may expressly prohibit the freezing, seizure or attachment of assets held in trust.
- Certain clauses commonly referred to as escape clauses, allow the law to which the trust is subject to be changed automatically if certain events arise. Such clauses make it possible to protect the assets deposited in the trust from legal action.

¹³ See FATF (2006) for a short explanation of trusts.

29. These conditions may create a significant obstacle for the authorities charged with applying anti-money laundering and counter terrorist financing laws – especially in relation to international co-operation – thus significantly slowing the process of collecting information and evidence regarding the very existence of the trust and identifying its ultimate beneficiary. Under these circumstances it may be very difficult, if not impossible, for a bank or other financial institution to comply with the “know-your-customer” policies applicable in the country or territory in which it is located.¹⁴

Case study 3.2: Use of trusts to buy real estate

(Predicate offence: suspected serious tax fraud)

Two trusts were established in an offshore centre by a law firm. The trustee had been requested to accept two payment orders in favour of a bank in order to buy real estate. The communication between these trusts and their trustee always took place through the law firm. It appeared that the trust had been used to conceal the identity of the beneficial owners.

Information obtained by the FIU revealed that the beneficiaries of the trusts were individuals A and B, who were managers of two companies, established in Belgium that were the subject of a judicial investigation regarding serious tax fraud. Part of the funds in these trusts could have originated from criminal activity of the companies.

Indicators and methods identified in the scheme:

- **Instruments: wire transfers, real estate.**
- **Mechanisms: lawyer, trust, bank.**
- **Techniques: trust account, purchase of real estate, legal entity transactor, offshore, and incoming wire transfer.**
- **Opportunity taken: use of trusts to buy real estate. The trusts were used to conceal the identity of the true owners.**

Source: Belgium, 2005.

Shell Companies

30. A shell company is a company that is formed but which has no significant assets or operations, or it is a legal person that has no activity or operations in the jurisdiction where it is registered. Shell companies may be set up in many jurisdictions, including in certain offshore financial centres and tax havens. In addition, their ownership structures may occur in a variety of forms. Shares may be held by a natural person or legal entity, and they may be in nominative or bearer form. Some shell companies may be set up for a single purpose or hold just one asset. Others may be set up for a variety of purposes or manage multiple assets, which facilitates the co-mingling of legal and illicit assets.

31. The potential for anonymity is a critical factor in the use of shell companies. They may be used to hide the identity of the natural persons who are the true owners or who control the company.¹⁵ In particular, permissive practices regarding the form of the shares, whether corporate, nominative or bearer, together with the lack of co-operation on the collection of information, represent a significant challenge when seeking to determine the ultimate beneficial owner.

¹⁴ However, it was pointed out in FATF (2006) that, in jurisdictions where trust administrators are licensed and regulated to ensure that they comply with FATF standards on knowing the beneficial owner, these difficulties might be able to be avoided.

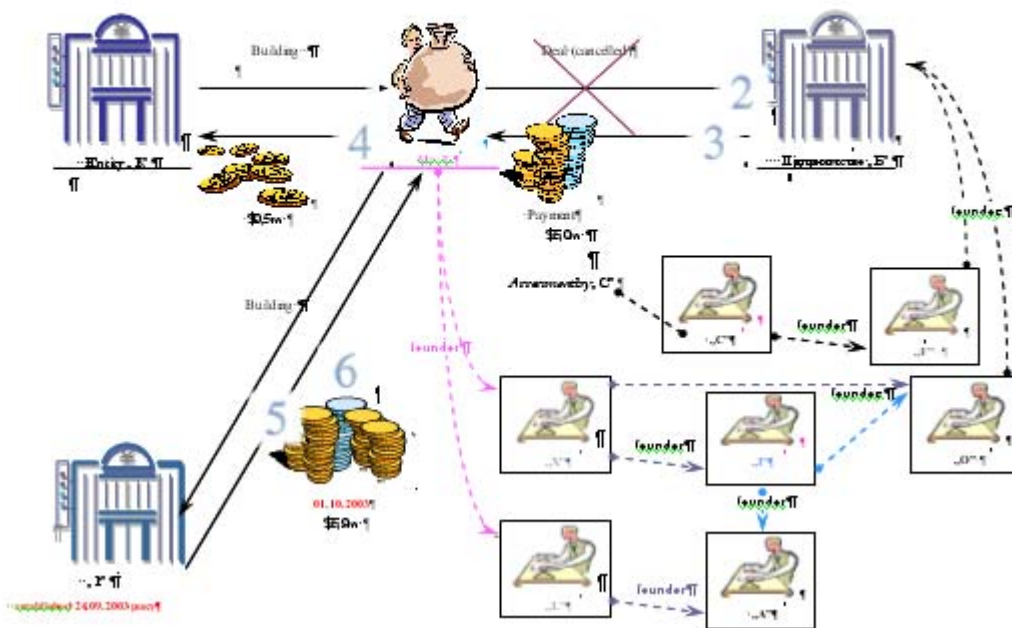
¹⁵ Commonly referred to as the *beneficial owner*.

Case study 3.3: Use of a shell company to buy real estate

This scheme involved the purchase of real estate, which was then sold for the higher price to the figureheads. In this case the financial intermediaries informed the financial intelligence unit (FIU) only about the transfer amount. To detect and investigate such cases it was therefore necessary to obtain information from relevant "gatekeepers", especially from registrars of real estate.

The case, investigated by Ukrainian FIU, started from the STR submitted by the auditor of the property buyer. Information was then received from the state registrar of real estate proprietors.

Drawing 5. Relations between parties of realty deal



Entity P bought the building in the Ukrainian capital.
 Entity K - first owner;
 Mr. T - first buyer;
 Entity B - next buyer. But the deal was cancelled in 3 months;
 Entity P - new buyer.

Suspicion about the transaction was aroused because:

The selling price of building was 10 times higher than purchase price 3 days later.
 The purchase price for Mr. T was determined based on the assessment of the state registrar of real estate.
 The selling price was based on the assessment of private expert from entity C.
 Mr. T did not have his own money. He would have had to work for 200 years to acquire this amount (USD 500 000) through his legal income. Nevertheless, on the day of payment, Mr. T received money from B as an advance for the same building.

In three months the deal with B was cancelled and the building was sold to P for USD 5.9 million. There are close relations between T, B and C, shown at the diagram. There was thus strong probability that the transfers of money to Mr. T were done for the purpose of laundering of USD 5.4 million.

Source: MONEYVAL (Ukraine).

Property Management Companies

32. When using the real-estate sector, the purchase or construction of properties is a commonly used means by which criminals carry out financial transactions. However, a property that is bought or constructed using illegally obtained funds may subsequently be rented out to provide an apparently

legal source of income in order to camouflage movements of funds between various jurisdictions (for example, the tenant and the landlord are located in different jurisdictions).

33. In cases where a company is owned or controlled by a criminal group, a possible way to use the property for money laundering is to mix cash of illegal origin with legitimate rental income. It then appears to be the result of the company's legitimate profits. In other cases, criminals seem to use the company's property management services to create a veil of legitimacy over other transactions they conduct. Those cases showed the active involvement of property management companies in criminal activity. The level of their participation can vary widely both in what kind of property is involved and how the property management company is being misused. The company may be an integral part of the organised criminal group or it may provide a part of the criminal business activity, fundamentally money laundering.¹⁶

Case study 3.4: Use of property management companies

(Predicate offence: suspected fraud)

The FIU received a suspicious transaction report from notary A on one of his clients, person B, a foreigner without an address in Belgium, who in his office had set up a company for letting real estate. The sole manager and shareholder of this company was a family member of B, who also resided abroad.

Shortly after its creation the company bought a property in Belgium. The formal property transfer was carried out at notary A's office. The property was paid for through the account of notary A by means of several transfers, not from company X, but from another foreign company about which individual B did not provide any details. The establishment of a company managed by a family member with the aim of offering real estate for let and paid by a foreign company disguised the link between the origin and the destination of the money.

Police intelligence revealed that the individual was known for financial fraud. The investment in the property was apparently financed by the proceeds of these funds.

Indicators and methods identified in the scheme:

- **Instruments: cash, wire transfers, real estate.**
- **Mechanisms: notary, bank.**
- **Techniques: business account, purchase of real estate, transactor inconsistencies, non-resident customer, unknown source.**
- **Opportunity taken: the establishment of a company managed by a family member with the aim of letting real estate paid by a foreign company disguised the link between the origin and the destination of the money**

Source: Belgium, 2005.

Non-trading real estate investment companies¹⁷

34. Several characteristics of these companies make them especially vulnerable to abuse by suspected criminals. First, it is often very difficult to identify the real owner or controller. Second, the company can be created very easily with no minimum initial capital and without an authentic deed. Additionally, these entities are only recorded at the trade register. Finally, the shares of such companies can be sold without certification so that the true owner is not easily identified.

¹⁶ See Serious Organised Crime Agency (2006).

¹⁷ Also known by its French acronym, *SCI* or *société civile immobilière*.

Case Study 3.5: Misuse of non trading real estate investment companies

(Predicate offence: suspected organised criminal activities)

Two French non-trading real estate investment companies managed by two residents of a western European country successively bought two high value properties for a significant amount (more than EUR 20 million) with a single payment (not a loan).

The analysis of the FIU revealed that beneficial owner of the two properties was a resident of an Eastern European country. Further analysis showed that offshore Company A had moved the funds used to purchase the properties through SWIFT wire transfers. This offshore company was well known for holding shares of Company B registered in the very same country as the beneficial owner of the properties. Company B itself was known for its links to organised crime. Analysis also showed that the two managers of the real estate investment companies were senior staff of Company B.

Indicators and methods identified in the scheme:

- **Instrument: real estate, single payment.**
- **Mechanisms: bank, *société civile immobilière* (SCI).**
- **Techniques: purchase of real estate, French SCI and foreign/offshore companies as intermediary, high value, physical intermediaries linked to the beneficial owner.**
- **Opportunity taken: the FIU analysis revealed that the 2 managers of the French SCI were linked to the beneficial owner through a company owned by him and in which the two managers had senior responsibilities**

Source: France, 2006.

Typology 4: Manipulation of the Appraisal or Valuation of a Property

35. Manipulation of the real value of properties in relation to real estate involves the overvaluing or undervaluing of a property followed by a succession of sales and purchases. A property's value may be difficult to estimate, especially in the case of properties that might be considered atypical, such as hotel complexes, golf courses, convention centres, shopping centres and holiday homes. This difficulty further facilitates the manipulation when such property is involved.

Over-valuation or Under-valuation

36. This technique consists of buying or selling a property at a price above or below its market value. This process should raise suspicions, as should the successive sale or purchase of properties with unusual profit margins and purchases by apparently related participants.

37. An often-used structure is, for example, the setting up of shell companies to buy real estate. Shortly after acquiring the properties, the companies are voluntarily wound up, and the criminals then repurchase the property at a price considerably above the original purchase price. This enables them to insert a sum of money into the financial system equal to the original purchase price plus the capital gain, thereby allowing them to conceal the origin of their funds.

Successive Sales and Purchases

38. In the case of successive sales and purchases, the property is sold in a series of subsequent transactions, each time at a higher price. Law enforcement cases have shown that these operations also often include, for example, the reclassification of agricultural land as building land. The sale is therefore fictitious, and the parties involved belong to the same criminal organisation or are non-financial professionals in the real-estate sector who implicitly know the true purpose of the transactions or unusual activity.

39. In addition to placing obstacles to discovering the true identity of the owners of the property and the real origin of the funds used in the transaction, these constructs usually also have a significant tax impact, as they generally avoid the liability for capital gains tax.

Case study 4.1: Use of a lawyer when buying a real estate.

(Predicate offence: suspected organised crime activity)

A lawyer created several companies the same day (with ownership through bearer shares, thus hiding the identity of the true owners). One of these companies acquired a property that was an area of undeveloped land. A few weeks later, the area was re-classified by the town hall where it is located so that it could be urbanised.

The lawyer came to the Property Registry and in successive operations, transferred the ownership of the property by means of the transfer of mortgage loans constituted in entities located in offshore jurisdictions.

With each succeeding transfer of the property, the price of the land was increased. The participants in the individual transfers were shell companies controlled by the lawyer. Finally the mortgage was cancelled with a cheque issued by a correspondent account. The cheque was received by a company different from the one that appeared as acquirer on the deed (cheque endorsement). Since the company used a correspondent account exclusively, it can be concluded that this company was a front company set up merely for the purpose of carrying out the property transactions.

After investigation it was learned that the purchaser and the seller were the same person: the leader of a criminal organisation. The money used in the transaction was of illegal origin (drug trafficking). Additionally, in the process of reclassification, administrative anomalies and bribes were detected.

Indicators and methods identified in the scheme:

- **Instruments: cheques and cover payments.**
- **Mechanisms: correspondent bank accounts.**
- **Techniques: business account, front company customer, purchase of real estate, cross border transaction, incoming wire transfer, reverse/flip real estate, unknown source.**
- **Opportunity taken: use of a lawyer when buying real property and performing bank transactions through correspondent bank accounts. Since the correspondent bank account was not used for any other transaction, it can be deduced that the lawyer set up the correspondent account for the purpose of carrying out the property transactions.**

Source: Spain, 2006.

Typology 5: Monetary Instruments

40. The use of monetary instruments in real estate transactions has traditionally dealt primarily with the use of cash. Although methods of payment continue to evolve, cash continues to be one of the main ways of obtaining and handling funds at the early stages of the process in many of the cases that ultimately involve funds of illegal origin.

41. Other monetary instruments used by criminals in their real-estate activities are cheques and wire transfers through conduit or correspondent bank accounts.

Cash

42. The purchase of high-value properties in cash is one way in which large sums of money can be integrated into the legal financial system. Some jurisdictions have observed that there has been a marked increase in demand for high denomination banknotes in their territory, which seems to be inconsistent with the progressive change in public preferences towards other means of payment. Specific geographic and financial concentrations of demand and cross-border movements have also been detected (specific locations, banks, ports, etc.). Although this demand also arises for reasons not strictly considered to be money laundering or terrorist financing activities, such as tax avoidance, evasion or fraud, it does seem to be clear that the real estate sector may be a key contributing factor in the increase in this demand for some jurisdictions, as the black economy tends to grow during a property boom.

43. As well as being used to buy real estate, cash is also used in currency exchange and to structure deposits. It is common to structure cash transactions involving funds from criminal or terrorist sources and then to use these funds to buy, build or renovate a property. When the improved property is finally

sold, the transaction has the advantage that it is difficult, or even impossible, to relate it to a specific individual or a criminal activity.

44. Cash is also used in rental or financial leasing transactions.¹⁸ These processes may be used by money launderers or terrorists to obtain the use of a property without having to fear losing it through its being seized or frozen if their criminal activity is discovered by the authorities. Moreover, it can also be used directly by criminals to settle contracts close to the start of the operation, receiving a reimbursement from the leasing company in the form of a cheque, for example, thus giving the transaction an air of legitimacy. It should be noted that this analysis found that a large share of the market remains in the hands of legal entities which are independent from the banks and financial institutions, thus creating a different channel for funds and making investigation and analysis difficult given the fragmentation of the information.

Case study 5.1: Use of cash to buy real estate

(Predicate offence: drug trafficking)

A criminal organisation operating in the Americas and Europe, laundered resources generated from drug trafficking through the misuse of bureaux de change and exploitation of apparently legitimate real-estate businesses in different countries. The criminal organisation led by Mr. B, sent cocaine from South America to Europe, disguising it in rubber cylinders that were transported by air. The money generated from the trafficking was collected in Europe and forwarded in the same way back across the Atlantic.

In Latin-American Country 1, Mr B acquired an existing bureau de change; he changed its name and became its main shareholder and general director. With the purchase of an already constituted financial institution, the criminal organisation avoided the strict controls implemented by the regulatory authorities as regards to the constitution and operation of financial entities.

In European country 2, the criminal organisation acquired commercialisation companies, created real estate corporations managed by citizens of Latin-American Country 1 and opened bank accounts in various financial institutions, declaring as commercial activity trading in jewels, financial intermediation and real estate activities, among others.

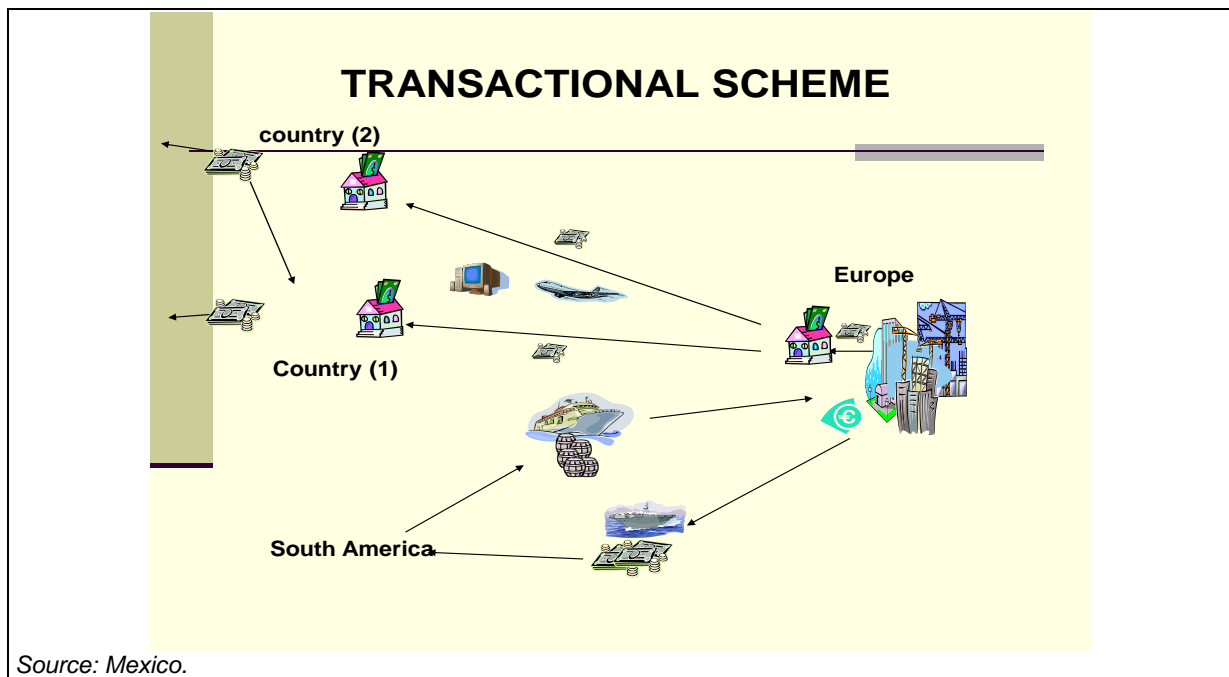
Those companies performed unusual transactions, such as cash deposits in amounts above EUR 500,000 and immediate transfer orders for the same amounts to foreign accounts belonging to Mr. B's bureau de change in Latin-American Country 1 and American Country 2; allegedly for investments in the real-estate sector; money was deposited in low denomination currency and some counterfeit notes were identified as well.

Intelligence information revealed that the account of the bureau de change located in American Country 2, received during a year and a half period, deposits for more than USD 160 million.

Indicators and methods identified in the scheme:

- **Maritime exportation of drugs from America to Europe and cash imports through the same route.**
- **Incorporation of jewellery and real-estate companies in Europe, managed by citizens of Latin-American Country 1 to launder the money generated from drugs trafficking.**
- **Acquisition of an existing bureau de change in Latin-American Country 1, opening several bank accounts located in Latin-American Country 1, American Country 2 and Latin-American Country 3.**
- **Cash deposits in amounts above EUR 500 000 on behalf of the real state corporations located in Europe and immediate transfer orders for the same amounts to foreign accounts belonging to Mr. B's bureau de change in Latin-American Country 1 and American Country 2; allegedly for investments in real state sector.**
- **Intelligence information revealed that the account of the exchange house located in American Country 2, received during a year and a half period, more than USD 160 million.**
- **No continuity in the resources in the accounts.**

¹⁸ Leasing is considered to mean contracts with the sole purpose of granting the use of real property purchased for this purpose in accordance with the specifications of the future user, in exchange for consideration in the form of the periodic payment of instalments to recoup the cost of the asset, excluding the value of the purchase option and financial charges. Leased goods must be used by the user solely for his business purposes. A financial leasing contract must include a purchase option in favour of the user at the end of the lease.



Cheques and Wire Transfers

45. A number of cases revealed that criminals frequently use what might be termed *payable-through accounts* to channel large sums of money, generally through a series of transactions. In many cases sums are initially paid into these accounts in cash, cheques or via international wire transfers. The money never stays in the account for long, the rate of turnover of the funds is high, and the funds are then used to purchase real estate. There would appear to be no commercial or economic justification for using these accounts. The same could apply to correspondent accounts when used as transit account. Suspicion about a legitimate use can be appropriate, when the account has high turnover, it appears to deal exclusively with wire transfer payments (MT 103 plus MT 202 messages) or cheques and the account appears to have no commercial or economic justification for such use.

46. Analysis of the accounts in the cases studied often showed that they were opened for the sole purpose of conducting transactions and operations of this type. The basic purpose of the operation was, as always, to conceal the true origin of the funds and their ownership.

Case study 5.2: Use of a transit account to buy real estate and launder the funds from human being trafficking

(Predicate offence: suspected trafficking in human beings)

A bank's suspicions were raised after a bank cheque was issued to the order of a notary upon request of an Asian national for purchasing real estate. Analysis of the account transactions showed that the account received several transfers from Asians residing abroad and was known through an investigation regarding a network of Asian immigrants. (

The analysis showed that the account had been used as a transit account by other Asian nationals for the purchase of real estate.

Indicators and methods identified in the scheme:

- **Instruments:** wire transfers, cheques, real estate.
- **Mechanisms:** notary, bank.
- **Techniques:** personal account, purchase of real estate, transit account, incoming wire transfer.
- **Opportunity taken:** use of a transit account by non resident nationals for purchasing real estate.

Source: Belgium, 2005

Typology 6: Mortgage Schemes

47. Mortgage loans comprise one of the main assets on the balance sheets of banks and other financial institutions. An inherent risk in this activity arises from the fraudulent or criminal use of these products. Through this misuse of the mortgage lending system, criminals or terrorists mislead the financial institution into granting them a new mortgage or increasing the amount already lent. This use constitutes, in the majority of the cases analysed, a part of the financial construction established to carry out criminal activities.

48. It was observed in many instances that financial institutions consider these mortgage products to be low risk. A risk-based approach to monitoring subjects related to money laundering and terrorist financing, similar to those based on customer due diligence or "know your customer" principles, could mitigate some of the risk of this activity.

Illegal Funds in Mortgage Loans and Interest Payments

49. Illicit actors obtain mortgage loans to buy properties. In many cases, illegal funds obtained subsequently are used to pay the interest or repay the principal on the loan, either as a lump sum or in instalments. The tax implications of using these products should also not be overlooked (for example, eligibility for tax rebates, etc.).

50. Front men are also sometimes used to buy properties or to apply for mortgages. The analysed cases seem to indicate that this misuse of mortgages goes hand in hand with a simulated business activity and the related income so as to deceive the bank or other financial institution when applying for the mortgage. On occasion the property is apparently purchased as a home, when in reality it is being used for criminal or terrorist activities (for example, selling or storing drugs, hiding illegal immigrants, people trafficking, providing a safe house for members of the organisation, etc.).

Case study 6.1: Use of illegal funds in mortgage loans and interest payments

(Predicate offence: forgery, deception, fraud, money laundering)

An individual used a front-man to purchase real estate. The value of the real estate was manipulated by using a licensed assessor (realestate agent) to set up a false higher but plausible assessment of the market value of the property after renovation. The bank was willing to grant a mortgage on the basis of this false assessment. After the disbursement of the loan the real estate was paid for. The remaining money was then transferred by the owner to bank accounts in foreign jurisdictions with strict bank secrecy. The renovation took never place. The company finally went into default and the loan could not be reimbursed.

A more detailed version of this scheme (describing all steps in the process) is included in Annex C.

Indicators and methods identified in the scheme:

- **Applying for a loan under false pretences.**
- **Using forged and falsified documents.**
- **The client persisted in representing his financial situation in a way that was unrealistic or that could not be supported by documents.**
- **The loan amount did not relate to the value of the real estate.**
- **Successive buying and selling transactions of the real estate were involved.**
- **The client had several mortgage loans concerning several residences**

Source: Netherlands.

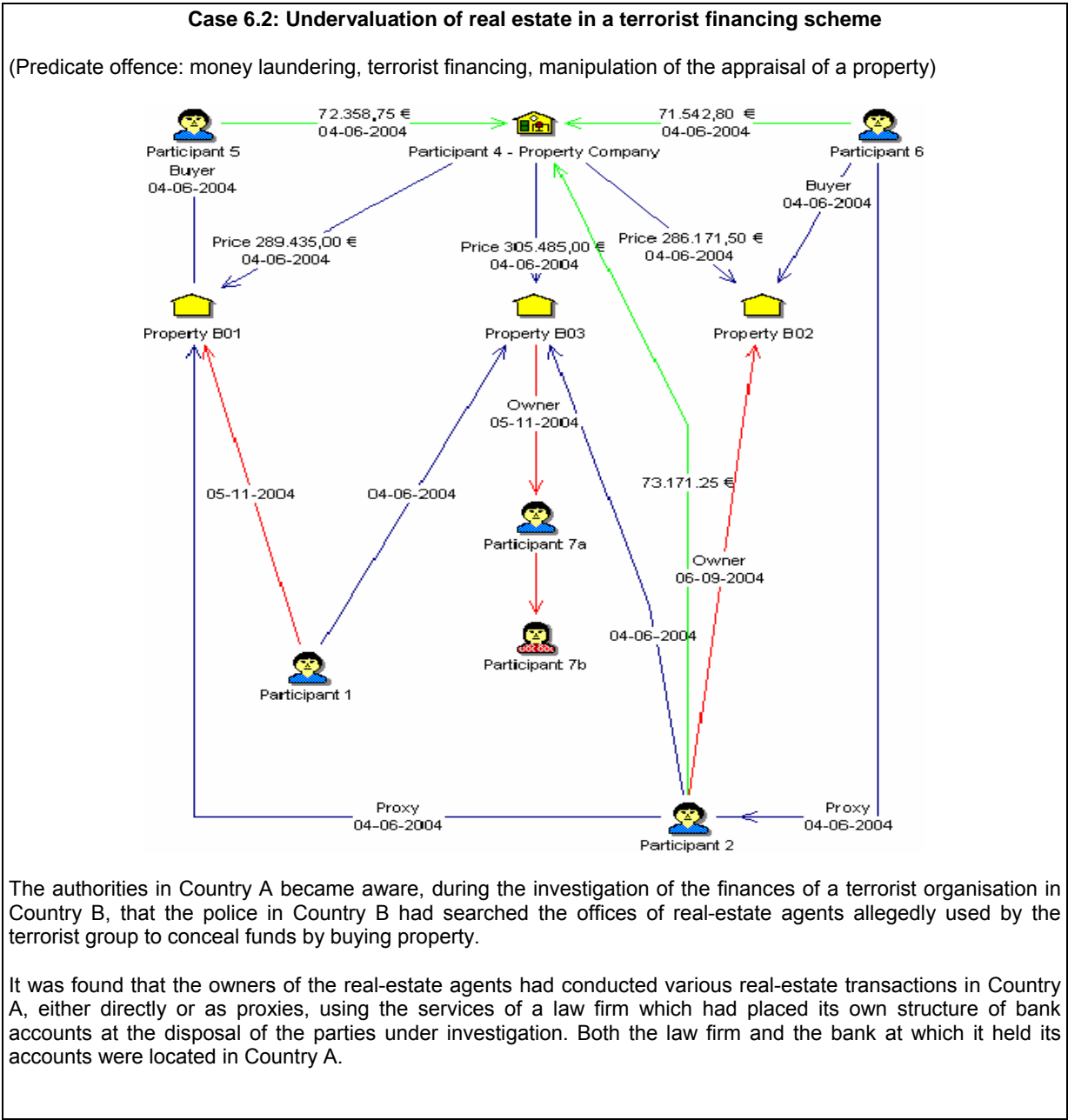
Under-valuation of Real Estate

51. Illicit actors often omit a part of the price from the purchase contract. In other words, the amount listed on the contract of sale is less than the real purchase price paid. The price shown on the contract is paid for with a mortgage loan; whereas the part not appearing on the contract is paid in cash

produced by the criminal organisation or terrorist group's criminal activities and is paid to the seller under the table.

52. When the property is sold at fair market price the illicit actor converts illegal income into seemingly legitimate profits. The proceeds might remain available in the bank account of the criminal organisation or terrorist group in the jurisdiction in which the property is located and thus constitute a critical starting point for an investigation.

53. If the criminal organisation or terrorist group is unable to find a seller willing to accept money under the table or is unable to influence the valuation of the property by the independent appraiser, it may still pay for part of the price set in the contract in cash from illegal activities, with a sum of money left over from not using the whole of the mortgage granted to it. In all these scenarios, it should be obvious to the bank or other financial institution that part of the purchase price is being paid via an alternative route, and it should verify whether this is consistent with the known profile of the customer in relation to the customer's pattern of income and expenses.



There was information in Country A regarding the involvement of participants 1 and 2 in the purchase of three properties. On a single day in 2005, Participants 1 and 2 made three deposits of EUR 3 210 each as down-payments to reserve properties in a residential complex in a coastal region of Country A for subsequent purchase. These properties were being built by the property company (Participant 4). Three un-notarised contracts of sale were signed by the property company and Participant 2, acting on his own behalf and as the verbal proxy of the purchasers (Participants 5, 6, 7). On the same day, Participant 1 transferred EUR 210 000 into the current account held by the law firm in Country A (Participant 3).

Three bank drafts were requested, for the sums of EUR 69 000, EUR 68 000, and EUR 73 000, with the funds being drawn from the law firm's current account. These were used to make the first payment against the contract of sale, which named the purchasers and set the final price.

Subsequently, after signing the property transfer documents before a notary in Country A, various assignments were made in the un-notarised contracts of sale that made changes to the final ownership of the properties:

- Participant 1 ultimately bought property B01, and parking space 01.
- Participant 2 ultimately bought property B02, and parking space 02.
- Participants 6 and 7 ultimately bought property B03, and parking space 03.

The law firm (Participant 3) undertook all the legal formalities and attended the signing of the transfer documents and acted as a translator for the purchasers.

To reconstruct the route taken by the funds used to buy the properties and to be reasonably sure of the origin of this money a number of obstacles had to be overcome. The first obstacle was the use of the bank drafts received by the property company in Country A (Participant 4) in each case. Bank drafts were used for the initial payments against the un-notarised contracts and the final payments before signing the deeds¹⁹.

These bank drafts were issued by the main office located near the properties and the relevant funds deducted from current account held by the law firm (Participant 3). Funds transfers were paid into this current account. On some occasions these referred to a person's name and in others a generic sender.

In the case of the property eventually purchased by Participant 1, at the time of signing the property transfers two certificates issued by a financial institution were submitted, certifying that the funds with which the property was being bought belonged to a non-resident in Country A.

The law firm (Participant 3) stated that at the time of agreeing to act as an advisor to Participant 1 that it knew Participant 1 to be a real-estate agent in Country B and that it was working for third parties who were interested in making investments in Country A, and that for this reason it was unaware of the origin of the funds being paid into its account for the transactions in which it was acting as an intermediary on behalf of Participant 1.

Examining each of the legal and financial transactions described above on their own there does not appear, at first glance, to be any suspicious activity. However, a look at the overall operation provides an argument for the conclusion that the people investigated and the law firm (Participant 3) were facilitating real-estate investments in Country A while hiding the origin of the funds and their true owner.

The purchase of the three properties was designed as a single transaction from the outset:

- The deposits were paid on the same date, as were the contracts of purchase with the property company (Participant 4) in Country A, and they were all signed by Participant 2.
- The funds used to make the first payments arrived in a single transfer, against which three bank drafts were requested. These drafts had sequential serial numbers.
- The three transactions have the same legal structure: payment of the deposit, un-notarised contract of sale, assignment of rights to a second purchaser by means of an un-notarised contract, and deed of sale in the name of a person other than the one who had initially signed the contract with the property company (Participant 4) in Country A.
- Various legal entities and natural persons acting on behalf of third parties intervened between the property and the final purchaser:
- The law firm (Participant 3), which had as its client a real estate agent in Country B, carried out legal transactions on behalf of third parties.

¹⁹ In the case of the property bought by Participant 2, it was impossible to obtain evidence of the means of payment used to make the final payment before signing the property transfer documents.

○ From the point of view of the property company, a law firm (Participant 3) and a property company in Country B were buying property on behalf of individuals who paid with bank drafts.

Indicators and methods identified in the scheme:

- The property which Participants 1 and 2 (who were the managers of the property companies in Country B) were going to buy for themselves was finally assigned to third parties.
- The properties that certain third parties were initially going to buy were finally bought by Participants 1 and 2 for themselves.
- One of the managers of the property company in Country B, Participant 1, bought an option to buy a property for four times its value even though the property was virtually identical to another which he already had the right to purchase and which he had transferred to a third party at cost. This would imply a profit of >250% if this price was actually paid, although in the contract there is no reference to the form or date of payment.
- Participant 1 first bought his property and then one month later applied for a mortgage on it. This may either be for tax reasons or a sign that the funds with which he acquired the property were not his.
- In addition to the parties investigated (Participants 1 and 2), there is a thread running throughout the operation as analysed, namely the law firm (Participant 3):
- The law firm (Participant 3) placed its current account with a bank in Country A at the disposal of Participants 1 and 2 so that they could send funds, while knowing that as professionals in the property business that they could open non-resident accounts in Country A either in the name of the company for which they worked or in their own names.
- The participants also obtained bank drafts for the various payments arising out of the contracts they signed. The combination of the use of bank drafts and the current account of a law firm considerably complicated the task of tracking the funds with which the property was bought, as, starting with the property transfer documentation it is necessary to contact the seller to obtain the bank draft number, and then obtain information about the origin of the funds used to purchase the draft from the bank, to finally arrive at the law firm.
- Given the active participation of the law firm in all the legal transactions relating to the properties (from the signing of the first, un-notarised contracts of sale, through to the signing of the property transfer documents, in which the law firm was present to act as a translator for the final buyers) the contract transferring the right of purchase that Participant 1 obtained from the purchaser (Participant 5) for four times its value can only be interpreted as a transaction intended to provide the buyer (Participant 5), or others, with an apparently legitimate origin for at least EUR 200 000.

Source: Spain 2006.

Over-valuation of Real Estate

54. Cases have also occurred in which illicit actors overvalued properties in order to obtain the largest possible mortgage. This over-valuation was achieved by manipulating the appraisal or by setting up a succession of purchases. Properties that have a more subjective valuation offer more scope for overvaluation, as is the case of hotel complexes, leisure centres, golf courses, restaurants, unique buildings, etc.

55. When applying for a mortgage, illicit actors often submit false documentation regarding the real value of the property underlying the operation. Additionally, they often use front men or corporate vehicles as a party to the mortgage agreement. The list of participants (for example directors, representatives, etc.) also changes frequently. On occasion, it has been noticed that some time after the mortgage was granted by the financial institution, the borrower defaulted on payment. When the bank tried to recover the debt from the front-man, it found that the latter did not know who was really behind the operation or where they might be located, leading to the debtor's being classified as insolvent. The same thing happens if the defaulter is a corporate vehicle.

Case 6.3: Overvaluation of real estate and used of third parties launder funds

(Predicate offence: money laundering, forged loan agreement)

The parents of Mr X (Mr and Mrs Y) purchased a residential property and secured a mortgage with a Canadian bank. In his mortgage application, Mr Y provided false information related to his annual income and his ownership of another property. The property he had listed as an asset belonged to another family member.

Mr and Mrs Y purchased a second residence and acquired another mortgage at the same Canadian bank. A large portion of the down payment came from an unknown source (believed to be Mr X). The monthly mortgage payments were made by Mr X through his father's bank account. This was the primary residence of Mr X. Investigative evidence shows that Mr X made all mortgage payments through a joint bank account held by Mr and Mrs Y and Mr X.

Mr X then purchased a residential property and acquired a mortgage from the same Canadian bank. Mr X listed his income (far higher than the amounts he had reported to Revenue Canada) from Company A and Company B. Mr X made the down payment and monthly payments. Over two years, Mr X paid approximately CAD 130 000 towards the mortgage. During this time his annual legitimate income was calculated to be less than CAD 20 000.

Mr X also used his brother Mr Z as a front man (nominee) on title to purchase an additional property. Investigators discovered that Mr Z had stated an annual income of CAD 72 000 on his mortgage application listing his employer as Mr X although Mr Z had never worked for his brother, and his total income for two years was less than CAD 13 000.

Mr X made the down payment on this property, and his tenants, who were members of Mr X's drug trafficking enterprise, paid all the monthly mortgage payments. A total of CAD 110 000 was paid towards this property until Mr X and his associates were arrested.

Mr X and his father purchased a fifth property. The origin of the down payment, made by Mr Y, was unknown but is believed to be the proceeds of Mr X's drug enterprise. Monthly payments were made by Mr X.

The use of real estate was one of many methods Mr X employed to launder the proceeds from his drug enterprise. Recorded conversations between Mr X and his associates revealed that he felt it was a fool-proof method to launder drug proceeds.

Mr X was convicted in 2006 of drug trafficking, possession of the proceeds of crime and laundering the proceeds of crime in relation to this case.

Indicators and methods identified in the scheme:

- **The use of real estate was one of many methods Mr X employed to launder the proceeds from his drug enterprise. Recorded conversations between Mr X and his associates revealed that he felt it was a fool-proof method to launder drug money.**
- **The only problem he faced was securing a mortgage alone, so he had to use a nominee to secure the mortgage or to co-sign on the mortgage. A problem surfaced in this investigation when various properties were sold prior to a restraint order being served. This resulted in a portion of the funds being secured in a lawyer's trust account, which could not be restrained. It was the investigator's belief that up to CAD 500,000 was being held in this trust account.**

Source: Canada 2006.

Typology 7: Investment Schemes and Financial Institutions

56. Direct or indirect investment in the real estate sector by banks and other financial institutions is significant.²⁰ However, the volume of investment by insurance companies and pension fund managers is also significant, as these institutions place a large part of their long-term liabilities in the property sector at both national and international levels. Bank and other financial institution investment policies demonstrate that investment in property is gaining ground relative to other direct investments.

²⁰ In the majority of countries, On the balance sheets of banks and financial institutions in most countries, the asset item referred to as credit investments mainly consists of mortgage lending transactions. This means that at times the evolution of the financial system is highly correlated with that of the real-estate sector.

57. Indirect investments are those considered to be limited or in which there is no direct control over the assets of the fund or investment vehicle. Moreover, real estate investment funds may or may not be publicly listed. If funds are unlisted it means that some or the entire fund or investment vehicle is capitalised by the financial institution. The number of co-investors generally ranges from two to ten.

58. The legal structures used for real estate investment funds vary:

- Investment trusts in the real estate sector, either listed or unlisted.²¹
- Companies operating in the real estate sector, either listed or unlisted.²²
- Associations and unlisted limited companies.

59. A number of cases have revealed that criminal organisations can influence property investment funds in various ways, depending on their degree of involvement:

- Partners in limited companies.
- Co-investors in property investment funds.
- Managers with direct or indirect control over the investment decisions made by property investment funds.

60. Institutions frequently outsource the management of their real estate assets to advisors or intermediaries, who, if they are managers of assets held in trust, may also outsource this task. Thus, several counterparties may be involved in the investment process, beginning with the investment policy set by the financial institution and ending with the investment ultimately made. The criminal organisation or terrorist group may operate or be situated at any point along this chain.

61. Through investment schemes in the real estate sector, the bank or other financial institution may, whether wittingly or not, facilitate or involve itself or become a vehicle for third parties to launder money.

Case study 7.1: Investments in hotel complexes through a front-man

(Predicate offence: organised criminal activities)

On the French west seacoast, an individual presented a project to a district planning authority which involved several real-estate project management companies to develop a golf course with a hundred villas and apartments on property owned by the authority.

The total cost of the operation was very high and was to be funded mostly with funds originating from abroad. The analysis of the FIU revealed that the individual as well as close members of his family had already been involved in previous cases transmitted to the judicial authorities, in which the family had been implicated in the laundering of funds originating from Eastern Europe.

Indicators and methods identified in the scheme:

- **Instrument: real estate.**
- **Mechanisms: bank, district-planning authority, real-estate project management companies.**
- **Techniques: purchase of real estate, involvement of a natural person as an intermediary, high value.**
- **Opportunity taken: the FIU investigations revealed that this individual and members of his family had acted as a front-man for persons from Eastern Europe suspected of being linked with organised crime.**

Source: France, 2006.

²¹ Known as *real estate investment trusts* (REITs) in the US and *property investment funds* (PIFs) in the UK.

²² Known as *real estate operating companies* (REOC) in the US.

Typology 8: Concealing Money Generated by Illegal Activities

62. The use of real estate to launder money seems to afford criminal organisations a triple advantage, as it allows them to introduce illegal funds into the system, while earning additional profits and even obtaining tax advantages (such as rebates, subsidies, etc.).

63. Some areas within the real-estate sector are more attractive than others for money laundering purposes, since the financial flows associated with them are considerable. This makes the task of hiding the funds of illegal origin in the total volume of transactions easier. The real estate sector offers numerous possibilities for money laundering: hotel businesses, construction firms, development of public or tourist infrastructure (especially luxury resorts), catering businesses. It is worth highlighting that over the course of the study, trends in these activities were noticed that depend on different regional characteristics: for example, more cases occur in coastal areas, in areas with a pleasant climate, and where non-resident foreign nationals are concentrated, etc. It is also worth noting that countries which have regions of this kind are more aware of the problem and have increasingly begun to establish appropriate measures and controls in the real-estate sector.

Investment in Hotel Complexes, Restaurants and Similar Developments

64. Real estate is commonly acquired in what is known as the integration or final phase of money laundering. Buying property offers criminals an opportunity to make an investment while giving it the appearance of financial stability. Buying a hotel, a restaurant or other similar investment offers further advantages, as it brings with it a business activity in which there is extensive use of cash.

Case study 8.1: Purchase of real-estate in order to establish a restaurant

(Predicate offence: trafficking in illegal labour force)

An Asian national had purchased real estate in order to start a restaurant that he had financed by a mortgage at Bank A. This mortgage was repaid by transfers from an account opened with Bank B in name of his spouse. Within one year his spouse's account was credited by cash deposits and debited by cash withdrawals, as well as transfers to Bank A.

On the debit side of the account there were also various transfers to China in favour of a natural person. The repayment of the mortgage by transfers from an account opened with another bank in name of his spouse.

The main individual involved was known to be part of network that illegally smuggled foreign workers to Belgium.

Indicators and methods identified in the scheme:

- **Instruments:** loan, wire transfer, cash, real estate.
- **Mechanisms:** bank.
- **Techniques:** personal account, purchase of real estate, physical person intermediary, cash deposit, withdrawal, outgoing wire transfer.
- **Opportunity taken:** repayment of the mortgage by transfers from an account opened with another bank in name of his spouse.

Source: Belgium, 2004.

RED FLAG INDICATORS

65. Building on the cases and other information analysed, the participants in this study also identified a number of common characteristics that, when detected individually or in combination, might indicate potential misuse of the real estate sector for ML/TF purposes. These “red flag” indicators when available can assist financial institutions and others in the conduct of customer due diligence for new and existing clients. They also may help in performing necessary risk-analysis in the more general sense for the sector. Thus, valid indicators may help in identifying suspicious activity that should be reported to competent national authorities according to AML/CFT legislation.

66. The indicators developed by this study of the real estate sector are set out in Annex B. They are not intended to represent an exhaustive list of all the possible types of transactions that might be linked to money laundering or terrorist financing. Nor does it imply that the transactions listed are necessarily linked to such activities. It needs to be borne in mind that money laundering always aims to disguise itself as a “normal” transaction. The criminal nature of the activity derives from the origin of the funds and the aim of the participants.

67. Because the international standard in this field primarily focuses on prevention, it is essential to emphasise two types of measures: *i)* Detection of suspicious transactions before they are completed, so as to avoid the funds being fed into the system; and *ii)* analysis of these transactions in cases where it is impossible to detect suspicious activity in order to detect such activity in the future.

ISSUES FOR CONSIDERATION

68. Regarding the real estate sector, there are other issues for consideration apart from the ones previously mentioned that can play a key role in the process of detecting misuse within the sector as a way to channel illicit money. Additionally, all the concerns expressed in the report have policy implications which need to be considered by countries either at a national or international level.

69. This study of typologies should help to identify the weaknesses or loopholes in the prevention systems currently in place, and may lead to the setting up or development of measures to protect the sector from criminal activities linked to money laundering, and thus avoiding its becoming an attractive destination for money obtained from criminal sources.

70. It is therefore important to highlight that the preventive framework to which this report aims to contribute must be constructed in accordance with the preventive measures laid down in these practices or systems. In the same way, it must be pointed out that any relaxation of the controls on these practices or systems could represent an enormous boost to the success of investments in the real estate sector by criminals.

71. In this context, the FATF should play a central role – together with World Bank and International Monetary Fund – in helping develop appropriate measures in emerging markets, as a way to stop illegal money flows.

72. Finally, as the key parties to real estate transactions, DNFBPs need to be encouraged by organisations and legislators in the fight against ML/TF. Real estate agents in particular are involved in the vast majority of real estate transactions and therefore can play a key role in detecting money laundering and terrorist financing schemes. Although this research has demonstrated the growing use of emerging markets and new methods of payments to launder money or finance terrorism through the real estate sector, simpler schemes such as large cash transactions are still commonly used. Because they are in direct contact with buyers and sellers, real estate agents generally know their clients better than the other parties in the transactions. Therefore, they are well placed to detect suspicious activity or identify red flag indicators.

73. The FATF Recommendations recognise the importance of customer due diligence, record-keeping and reporting requirements for the real estate sector. To ensure effective compliance with these requirements, it is important that authorities inform the sector of its obligations and share sector-specific indicators with the industry.

74. Also, it was observed during the research for the project that wire transfers still constitute the best way to allocate money between countries. Although controls have been established within the financial sector and for certain actors within it, settlement systems are still not included in the ML/TF legislation in most countries.

75. Finally, as they are key figures within the real estate sector and its transactions, designated non-financial businesses and professions (DNFBPs) need to be encouraged by organisations and legislators to implement effective AML/CFT measures.

Emerging markets

76. The worldwide market growth of real estate-backed securities and the development of property investment funds has meant that the range of options for real estate investments has also grown. Emerging markets in particular can offer attractive returns at low prices with considerable room for growth. This has not gone unnoticed by many suspected criminals.

77. As a result of a the property boom in emerging markets, it has come to light that many money launderers believe that it is easier to camouflage genuine commercial transactions - funded by their illicitly obtained funds - among the huge number of transactions taking place. Complicating matters is the fact that often these less developed economies do not have an average market price for real estate but rather prices varying across sectors and districts. Examining each and every transaction is impossible, and obtain a clear valuation of its real price is therefore also impossible. At times this situation is made worse by the fact that the banking sector is insufficiently developed, in terms of its financial products and conditions, resulting in financial and company structures that make the tasks of supervision or investigation yet more difficult.

78. Emerging markets often contain several characteristics that are highly favourable for money laundering, including:

- A high level of state intervention as a result of private sector financial structures and banking systems still at the embryonic stage.
- Absence, or limited development, of AML/CFT legislation and absence of indicators of the seriousness and social impacts of these phenomena.
- Lack of foreign capital in sectors other than raw materials.
- Banking and competent authorities (*i.e.* police, tax authorities, courts, etc.) lack training and the means necessary to detect and combat money laundering and terrorist financing.

Wire transfers

79. This method is common to practically all the schemes analysed and is probably one of the most accessible and widely used methods by criminals. The growing introduction of new technologies in financial markets and their increasing globalisation have meant that borders are disappearing and there are fewer obstacles to both legal and illegal activities. It also needs to be borne in mind that as a result of their growing use, the regulatory standards applicable to the financial markets regarding these wire transfers are scant as regards preventing money laundering and terrorist financing, and focus almost exclusively on the standardisation of the data fields used in order to automate and speed up transactions.

80. It needs to be borne in mind that wire transfers can be performed by highly regulated financial institutions and also through by less regulated institutions, such as alternative remittance systems. We need to also include those institutions providing message services and settlement services (*e.g.* FEDWIRE, CHIPS, SWIFT, etc). Therefore differentiating between the providers of the activity on a risk based manner seems appropriate. Additionally, we need to take into consideration the system and instrument used in each institutions to perform their transactions in relation to the regulation level. It means that we need not only consider the institutional regulation, but also if the money flows go through saving accounts, correspondent accounts, cheques, etc that can be considered as wire transfers.

81. The minimal information customers are required to provide in some jurisdictions to prove their identity facilitates the abuse of the system by criminal organisations and terrorist groups by making it possible for them to be almost undetectable while moving large sums of money between countries in seconds. The speed of execution, whether in person or not, the minimal documentation required and the high level of anonymity mean that they are commonly used by money launders abusing these regulatory loopholes. The fact that in only a few countries wire transfer offices are being supervised and subject to anti money laundering and counter terrorist financing requirements, makes the offices even more vulnerable for misuse.

82. Wire transfer systems move billions every day in domestic and international transfers, and although some countries have introduced limited standards for their surveillance, they are extremely difficult to control. It may be concluded from the information compiled that there are no effective

international controls on wire transfers, particularly as regards international transfers. It would be worthwhile to look into the current standards for the category. It could be said that the reliable identification of the parties (payer, payee, etc.) in wire transfer is indispensable to any effective effort to combating money launderings.

Notaries, registrars and similar figures

83. As illustrated throughout this report, notaries and registrars seem to be the weakest link in the chain of real estate transactions, and they may be able to play a role in the detection of high risk transactions relating to the real estate sector. The importance of AML/CFT requirements for third parties has already been recognised by the FATF under Recommendation 9. Due to their central position in the legal system in relation to these real estate transactions, they could potentially also perform a role in centralising and filtering information. However according to the legal professions it is not clear what the boundaries are in complying with the requirements. The FATF is currently undertaking a dialogue with the legal professions and further work in guidance on the recommendation will be elaborated. Some FATF members have charged prevention bodies within the professional associations to which notaries and registrars belong with providing information to the authorities (both judicial and administrative) with powers in relation to money laundering and terrorist financing under the authority of national laws.

84. In countries where the legal professions are considered public servants, a possible solution would be that a system put in operation by notaries and registrars would encompass, in particular, the identification and analysis of patterns of transactions where there is a risk of their concealing money laundering or terrorist financing activities. These models should include mechanisms for notifying financial intelligence units, for example, of those cases in which the level of risk increases or does not decrease after analysis. On this basis, the co-operation of notaries and registrars in the fight against ML and TF would be more clearly supported. It should obviously be pointed out that only a small proportion of these transactions constitute or form part of real money laundering or terrorist financing activities, a conclusion which can only be reached by the competent authorities.

85. Some FATF members consider an overall database at the level of the professional association²³, which would include the majority of the details of all transactions authorised by a notary or registrar and thus serve as the central gathering point for information from these public servants. However, in establishing system like this, countries would also need to consider cost effectiveness and privacy protection issues. A series of risk templates could be applied to this database to extract the relevant information required automatically for subsequent analysis. Approaching openly these gatekeepers and raising awareness on their vulnerabilities and risks as regards to money laundering and or terrorism financing is crucial for the competent authorities in order to reinforce the preventive network against those offences.

²³ From the research, it was clear that, because of the complex nature of real estate transactions, authorities experience difficulties in getting a complete picture of the role played by a person in the financial system. The nationwide database of financial products through which the authorities would be able to locate accounts and other products and then approach the relevant financial institution or other actors in the sector to seek more information through appropriate investigative or judicial means could help in this regard to provide a more complete picture.

ANNEX A - TERMINOLOGY²⁴

Beneficial owner: This term refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement. As used in this study, the term *beneficial owner* applies as well to the true owner of real property.

Instrument – An ML/TF *instrument* is an object of value (or one which represents value) that in some way or other is used to carry out ML/TF activity. Examples of ML/TF *instruments* include cash funds, cheques, travellers' cheques, precious metals or stones, securities, real property, etc.

Legal arrangements – This term refers to express trusts or other similar structures, such as (for AML/CFT purposes) the *fiducie*, *Treuhand* and *fideicomiso*.

Legal persons – A legal person is a corporate body, foundation, Anstalt, partnership or association, or any similar entities that can establish a permanent customer relationship with a financial institution or otherwise own real property.

Mechanism – An ML/TF *mechanism* is a system or element that carries out part of the ML/TF process. Examples of ML/TF *mechanisms* include financial institutions, money remitters, legal entities and legal arrangements, etc.

Method – In the ML/TF context, a *method* is a discrete procedure or process used to carry out ML/TF activity. It may combine various techniques, mechanisms and instruments, and it may or may not represent a typology in and of itself.

Scheme – An ML/TF *scheme* is a specific operation or case of money laundering or terrorist financing that combines various methods (techniques, mechanisms and instruments) into a single structure.

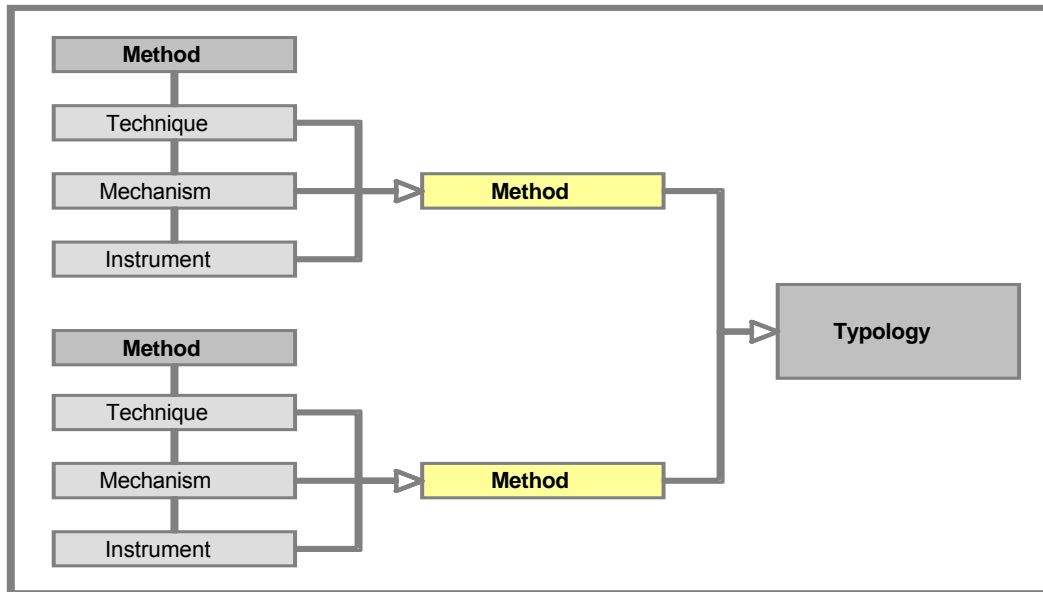
Technique – An ML/TF *technique* is a particular action or practice for carrying out ML/TF activity. Examples of ML/TF *techniques* include structuring financial transactions, comingling of legal and illegal funds, over- and under- valuing merchandise, transmission of funds by wire transfer, etc.

Trust and Company Service Provider (TCSP): This term refers to all persons or businesses that specialise in acting as a formation agent of legal persons for third parties. For a fuller definition of this type of activity, see the “Glossary” to the *FATF 40 Recommendations*.

Typology – An ML/TF *typology* is a pattern or series of similar types of money laundering or terrorist financing schemes or methods.

This report uses the terminology commonly used by the FATF in its typologies analysis. The following figure illustrates the relationship between the various elements of typologies analysis.

²⁴ Sources used for these terms include FATF (2003), FATF (2004) and FATF (2005).



ANNEX B - RED FLAG INDICATORS

Building on the cases and other information analysed, the participants in this study also identified a number of common characteristics that, when detected individually or in combination, might indicate potential misuse of the real estate sector for ML/TF purposes. These “red flag” indicators when available can assist financial institutions and others in the conduct of customer due diligence for new and existing clients. They also may help in performing necessary risk-analysis in the more general sense for the sector. Thus, valid indicators may help in identifying suspicious activity that should be reported to competent national authorities according to AML/CFT legislation.

These indicators are not intended to represent an exhaustive list of all the possible types of transactions that might be linked to money laundering or terrorist financing. Nor should it in any way be implied that the transactions listed here are *necessarily* linked to such activities. It should be remembered that activities related to money laundering or terrorist financing are always carried out with the aim of appearing to be “normal”. The criminal nature of the activity derives from the origin of the funds and the aim of the participants.

Natural persons

- Transactions involving persons residing in tax havens or risk territories²⁵, when the characteristics of the transactions match any of those included in the list of indicators.
- Transactions carried out on behalf of minors, incapacitated persons or other persons who, although not included in these categories, appear to lack the economic capacity to make such purchases.
- Transactions involving persons who are being tried or have been sentenced for crimes or who are publicly known to be linked to criminal activities involving illegal enrichment, or there are suspicions of involvement in such activities and that these activities may be considered to underlie money laundering
- Transactions involving persons who are in some way associated with the foregoing (for example, through family or business ties, common origins, where they share an address or have the same representatives or attorneys, etc.).
- Transactions involving an individual whose address is unknown or is merely a correspondence address (for example, a PO Box, shared office or shared business address, etc.), or where the details are believed or likely to be false.
- Several transactions involving the same party or those undertaken by groups of persons who may have links to one another (for example, family ties, business ties, persons of the same nationality, persons sharing an address or having the same representatives or attorneys, etc.).
- Individuals who unexpectedly repay problematic loans or mortgages or who repeatedly pay off large loans or mortgages early, particularly if they do so in cash.

²⁵ The definition of a risk territory could be either one that is determined by the financial institution or another entity applying the indicator directly or else one that has been defined by the national authorities of the country in which the institution or entity is located.

Legal persons

- Transactions involving legal persons or legal arrangements domiciled in tax havens or risk territories, when the characteristics of the transaction match any of those included in the list of indicators.
- Transactions involving recently created legal persons, when the amount is large compared to their assets.
- Transactions involving legal entities, when there does not seem to be any relationship between the transaction and the activity carried out by the buying company, or when the company has no business activity.
- Transactions involving foundations, cultural or leisure associations, or non-profit-making entities in general, when the characteristics of the transaction do not match the goals of the entity.
- Transactions involving legal persons which, although incorporated in the country, are mainly owned by foreign nationals, who may or may not be resident for tax purposes.
- Transactions involving legal persons whose addresses are unknown or are merely correspondence addresses (for example, a PO Box number, shared office or shared business address, etc.), or where the details are believed false or likely to be false.
- Various transactions involving the same party. Similarly, transactions carried out by groups of legal persons that may be related (for example, through family ties between owners or representatives, business links, sharing the same nationality as the legal person or its owners or representatives, sharing an address, in the case of legal persons or their owners or representatives, having a common owner, representative or attorney, entities with similar names, etc.).
- Formation of a legal person or increases to its capital in the form of non-monetary contributions of real estate, the value of which does not take into account the increase in market value of the properties used.
- Formation of legal persons to hold properties with the sole purpose of placing a front man or straw man between the property and the true owner.
- Contribution of real estate to the share capital of a company which has no registered address or permanent establishment which is open to the public in the country.
- Transactions in which unusual or unnecessarily complex legal structures are used without any economic logic.

Natural and legal persons

- Transactions in which there are signs, or it is certain, that the parties are not acting on their own behalf and are trying to hide the identity of the real customer.
- Transactions which are begun in one individual's name and finally completed in another's without a logical explanation for the name change. (For example, the sale or change of ownership of the purchase or option to purchase a property which has not yet been handed over to the owner, reservation of properties under construction with a subsequent transfer of the rights to a third party, etc.).
- Transactions in which the parties:
 - Do not show particular interest in the characteristics of the property (*e.g.* quality of construction, location, date on which it will be handed over, etc.) which is the object of the transaction.
 - Do not seem particularly interested in obtaining a better price for the transaction or in improving the payment terms.
 - Show a strong interest in completing the transaction quickly, without there being good cause.

- Show considerable interest in transactions relating to buildings in particular areas, without caring about the price they have to pay.
- Transactions in which the parties are foreign or non-resident for tax purposes and:
 - Their only purpose is a capital investment (that is, they do not show any interest in living at the property they are buying, even temporarily, etc.).
 - They are interested in large-scale operations (for example, to buy large plots on which to build homes, buying complete buildings or setting up businesses relating to leisure activities, etc.).
- Transactions in which any of the payments are made by a third party, other than the parties involved. Cases where the payment is made by a credit institution registered in the country at the time of signing the property transfer, due to the granting of a mortgage loan, may be excluded.

Intermediaries

- Transactions performed through intermediaries, when they act on behalf of groups of potentially associated individuals (for example, through family or business ties, shared nationality, persons living at the same address, etc.).
- Transactions carried out through intermediaries acting on behalf of groups of potentially affiliated legal persons (for example, through family ties between their owners or representatives, business links, the fact that the legal entity or its owners or representatives are of the same nationality, that the legal entities or their owners or representatives use the same address, that the entities have a common owner, representative or attorney, or in the case of entities with similar names, etc.).
- Transactions taking place through intermediaries who are foreign nationals or individuals who are non-resident for tax purposes.

Means of payment

- Transactions involving payments in cash or in negotiable instruments which do not state the true payer (for example, bank drafts), where the accumulated amount is considered to be significant in relation to the total amount of the transaction.
- Transactions in which the party asks for the payment to be divided in to smaller parts with a short interval between them.
- Transactions where there are doubts as to the validity of the documents submitted with loan applications.
- Transactions in which a loan granted, or an attempt was made to obtain a loan, using cash collateral or where this collateral is deposited abroad.
- Transactions in which payment is made in cash, bank notes, bearer cheques or other anonymous instruments, or where payment is made by endorsing a third-party's cheque.
- Transactions with funds from countries considered to be tax havens or risk territories, according to anti-money laundering legislation, regardless of whether the customer is resident in the country or territory concerned or not.
- Transactions in which the buyer takes on debt which is considered significant in relation to the value of the property. Transactions involving the subrogation of mortgages granted through institutions registered in the country may be excluded.

Nature of the Transaction

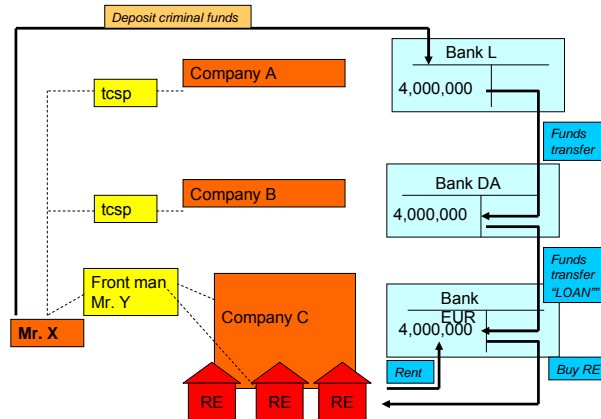
- Transactions in the form of a private contract, where there is no intention to notarise the contract, or where this intention is expressed, it does not finally take place.
- Transactions which are not completed in seeming disregard of a contract clause penalising the buyer with loss of the deposit if the sale does not go ahead.
- Transactions relating to the same property or rights that follow in rapid succession (for example, purchase and immediate sale of property) and which entail a significant increase or decrease in the price compared with the purchase price.

- Transactions entered into at a value significantly different (much higher or much lower) from the real value of the property or differing markedly from market values.
- Transactions relating to property development in high-risk urban areas, in the judgement of the company (for example, because there is a high percentage of residents of foreign origin, a new urban development plan has been approved, the number of buildings under construction is high relative to the number of inhabitants, etc.).
- Recording of the sale of a building plot followed by the recording of the declaration of a completely finished new building at the location at an interval less than the minimum time needed to complete the construction, bearing in mind its characteristics.
- Recording of the declaration of a completed new building by a non-resident legal person having no permanent domicile indicating that the construction work was completed at its own expense without any subcontracting or supply of materials.
- Transactions relating to property development in high-risk urban areas based on other variables determined by the institution (for example, because there is a high percentage of residents of foreign origin, a new urban development plan has been approved, the number of buildings under construction is high relative to the number of inhabitants, etc.).

ANNEX C – COMPLETE CASE STUDIES FOR TYPOLOGIES 1 AND 6

Case Study 1.1: Proceeds of drug trafficking laundered into real estate

Mr. X deposited money earned from drug activities into Company A's account at offshore Bank L. Mr. X set up Company A in order to disguise his identity and to place his criminal funds the bank under false pretences. Mr. X also held **bearer shares** issued by Company A., Mr X. established Company B in another offshore jurisdiction under the same circumstances.



Mr X was shareholder of Company A and B but was not registered as such in the public registers. Mr. X made use of a local trust in each location and gave them power-of-attorney to act as his legal representative (through a trust and company service provider: **T CSP**). The local trusts opened accounts at Bank L and at Bank DA on behalf of Company A and Company B respectively. The trusts explained to the banks that the companies that they represented were part of an international structure and that they wanted to benefit from favourable tax arrangements by means of **inter company loans**. This was the reason given for frequent debits and credits of the accounts for incoming and outgoing foreign funds transfers.

Mr X set up Company C in the European country where he is living. Mr. X is the owner of Company C; however, he uses a **front-man**, Mr Y, who is the owner and manager according to the public register at the Chamber of Commerce and the shareholder register. Company C conducted legal counselling activities. This way Mr. X was able to monitor and control the activities in Company C without becoming known to the authorities. Mr Y opened accounts on behalf of Company C with Bank EUR.

Mr X used Companies A, B and C to set up a **loan-back scheme** in order to transfer, layer and integrate his criminal money. The criminal funds, initially placed in the account of Company A in a bank in an offshore jurisdiction, were ultimately invested into real estate in Europe. The real estate was used to expand his legal counselling activities in Company C. The set up of the international loan-back structure, involving Company A, B and C, complicated the audit trail, legitimated the international funds transfers between the various bank accounts of the companies that Mr X controlled. Also Mr X **co-mingled** the criminal funds, disguised as a loan, with the funds originating from the legal activities of Company C, which made the criminal funds difficult to detect and to trace, thus involving a company with legitimate activities in the money laundering scheme, *i.e.* the integration phase (and avoiding attracting the attention of the authorities).

Mr. X arranged for Mr. Y to buy real estate. To finance the transaction, Mr. X arranged for a loan agreement to be drawn up between Companies B and C. The parties in the contract were the trust of Company B and Mr. Y of Company C. To execute the cash disbursement under the loan, Mr. X ordered the trust of Company A to transfer funds from the account in Bank L to the account of Company B in Bank DA. Next he ordered the trust of Company B to transfer funds from the account in Bank DA to the account of Company C in Bank EUR. The description given to Bank DA en Bank EUR referred to the loan agreement between Company B and C. Both banks did not know about the relationship between Companies B and C. The funds deposited in the account of Company C in Bank EUR were then transferred to the seller of the real estate. Periodically Company C made payments of the principal and interest to Company B from the earnings of the counselling activities. Company B transferred the money to Company A which was used by Mr. X to finance his criminal activities. The interest costs were deducted from the taxable result and declared in the tax return.

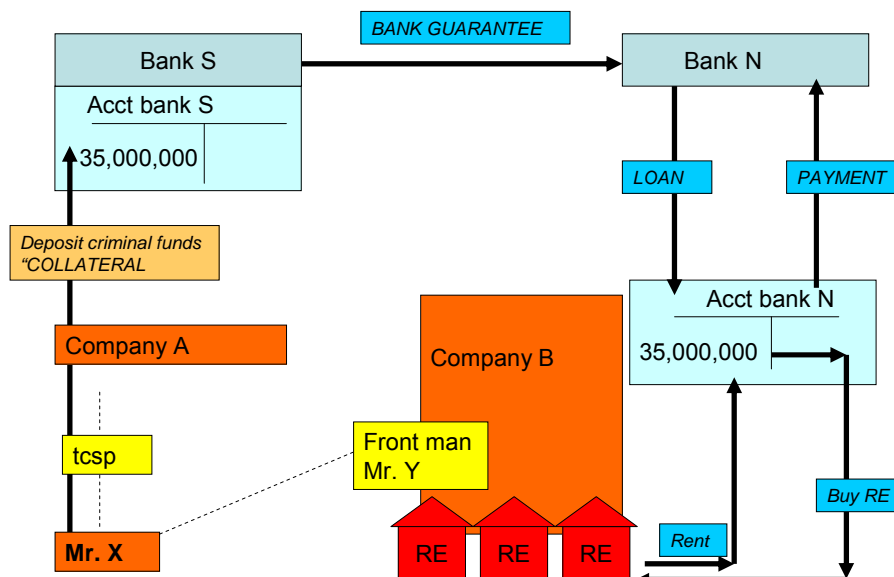
Indicators and methods identified in the scheme:

- The source of the funds used to finance the real estate transaction was from abroad, in particular from off shore jurisdictions and jurisdictions that have strict bank secrecy.
- The lender of the money, an offshore company, had no direct relation with the borrower of the money
- A financial institution was not involved in the loan structure.
- There was no loan agreement between the lender and borrower.
- The loan agreement was legally invalid.
- The information in the loan agreement was inconsistent or incorrect.
- The conditions in the loan agreement were unusual, for example, there was no collateral required.
- No payment of interest or repayment of the principal.
- Transaction monitoring by the financial institutions showed payable-through accounts, by which incoming payments from abroad were transferred abroad immediately without a logical reason.

Source: Netherlands.

Case Study 1.2: Back-to-back Loan Used to Launder Funds

(Predicate offence: forged loan agreement, in particular the failure to mention the security underlying the loan and money laundering)



Mr. X was a criminal who deposited funds via one of his corporate vehicles (Company A) into an account at Bank S. Company A was in an offshore jurisdiction that had strict bank secrecy. Mr X. was the owner of Company A, did not want to disclose his identity and thus used a **TCSP** to manage Company A. Mr. X used Company C to mask his real identity. Mr X also set up and controls Company B of which he is the owner. According to the public registers, the official owner and manager of Company B was Mr. Y who acts as a **front-man**. Company B owned several buildings that were rented out to natural persons and companies. This way Mr. X generated legal rental income via Company B.

Mr. X was short of money from legitimate sources to expand his legal activities. Based on the financial situation of Company B, Bank N was not willing to grant a loan without additional security. He set up a **back-to-back loan** structure to use his criminal money to invest in real estate.

Bank N was willing to lend money to Company B under the condition that Company B provided sufficient collateral and was willing to pay a high-risk premium on top of the market interest rate. Mr. X. arranged for Bank S to provide a **bank guarantee** to Bank N which could be drawn by Bank N on Bank S in case of a default on the loan. Bank N's credit risk regarding Company B was then fully covered. The loan fit into the financial situation and activities of Company B.

Bank S was willing to provide the bank guarantee to Bank N in name of Company A, with the **pledged deposit** as collateral. The money deposited in Bank S originated from the criminal activities of Mr. X. If Bank N were to withdraw the guarantee on Bank S, Bank S would have used the deposit pledged by Company A to settle the payment with Bank N. For Bank N the original collateral provider Company A, *i.e.* Mr X, was not visible. Bank N only saw Bank S's guarantee. Bank N lent the money to Company B. Through the payment by Bank N as part of the reimbursement of the back-to-back loan, Mr. X was able to provide a valid reason for the money used to finance the real estate. The collateral originated from criminal activities. The laundered money was invested in real estate that provided for legal rental income.

The earnings of Company B were continuously skimmed off by Mr. X to finance his illegal activities. Company B initially made loan and interest payments to Bank N. After a period of time, Company B stopped the payment of the principal and interest. Based on the loan agreement and the banking terms, Bank N withdrew the bank guarantee on Bank S. Bank S used the pledged deposit to settle the payment to Bank N.

Indicators and methods identified in the scheme:

- **No reference in the loan agreement to the underlying collateral.**
- **The collateral provided was not sufficient**
- **The collateral provider and other parties involved in the loan structure were not known.**
- **The borrower of the money was not willing to provide information on the identity and background of the collateral provider nor on the other parties involved in the loan structure.**
- **The complex nature of the loan scheme could not be justified**
- **There was an unexpected loan default.**

Source: Netherlands.

Case study 6.1: Use of Illegal Funds in Mortgage Loans and Interest Payments

(Predicate offence: forgery, deception, fraud, money laundering)

Mr. X was the owner of Company A and the individual controlling its activities. Mr. X hired Mr. Y as **front man** of Company A. Company A had some low-profile activities in managing and exploiting properties. During the life of Company A, Mr. Y set up a relationship with Bank EUR that provided for accounts and payment services. The property managed by Company A was used for activities by other companies owned by Mr. X (for storage, for example).

Mr. X. planned to buy office buildings for EUR 8 000 000 via Company A. The office buildings had to be renovated to be marketable. Mr. X. knew a licensed assessor (real estate agent), Mr. Z. Mr. X. and Mr. Z found a way to set up a **false but plausible assessments of the market value** of the office buildings after renovation (EUR 13 000 000). Mr. X ordered Mr. Y to negotiate a **mortgage** with Bank EUR to finance the purchase and renovation of the property. Based on the assessment, Bank EUR was willing to grant a mortgage of EUR 13 000 000. Mr. Y entered into the loan agreement on behalf of Company A as the buying party. After the disbursement of the loan, the real estate was paid for. Mr X. then paid Mr. Y EUR 500 000 and had the remaining EUR 4.5 million, together with the proceeds of other criminal activities, transferred into several bank accounts in countries with strict **bank secrecy**. The mortgage of Bank EUR was presented to the foreign banks as the legitimate source of the funds that were being transferred to the accounts. In this way, the money was layered and integrated. The renovation of the office buildings never took place. Meanwhile the activities of Company A rapidly decreased. Company A finally went into default. Bank EUR called the loan, but Mr. Y was not in a position to reimburse it along with the interest payment. Mr Y stated that he was not aware of the persons behind Company A, their whereabouts and the background of the accounts to which the money was transferred.

Indicators and methods identified in the scheme:

- **Applying for a loan under false pretences.**
- **Using forged and falsified documents.**
- **The client persisted in a picture of the financial situation that was unrealistic or that could not be supported by documents.**
- **The loan amount did not relate to the value of the real estate.**
- **Successive buying and selling of the real property involved.**
- **The client had several mortgage loans relating to several residences**

Source: Netherlands.

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