



## REGULATING LUXURY INVESTMENTS: WHAT DIRTY MONEY CAN'T BUY

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Most international standards and law enforcement agencies focus their efforts on fighting money laundering by banks and financial institutions. However, several non-financial sectors, such as real estate and luxury goods, are extremely vulnerable to illicit financial flows. Now is the time to clean up the sector and close this loophole for the corrupt.

Luxury investments, such as in goods and real estate, are among the preferred means for corrupt individuals to hide the illicit origin of their funds. The proceeds of corruption are often used to purchase real estate, sports cars and limousines, yachts, jet planes, precious metals and jewellery. By doing so, the corrupt not only benefit from their illicitly-gotten gain, but make it harder for tax and law enforcement authorities to detect the murky origin where the funds originated.

Purchases in the luxury goods sector represent a safe bet for the corrupt. Besides providing a “badge of wealth”, the sector goes largely unchecked by law enforcement authorities. This is in spite of the fact that in several countries the luxury goods sector is formally required to comply with anti-money laundering obligations similar to those imposed on financial institutions.

For Transparency International, this loophole must be closed. Corrupt individuals must be stopped from laundering illicit funds through luxury investments. They cannot be left free to enjoy their ill-gotten gains with impunity.

It is crucial to adopt legal measures and fully enforce regulations (where already existing) that require non-financial businesses trading in high-value goods to comply with anti-money laundering obligations such as due diligence, record keeping and suspicious activities reporting.

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## THE ISSUE

### LUXURY GOODS AS A SAFE HAVEN

Stolen assets often find their way into the luxury goods sector.<sup>1</sup> The purchase or investment in luxury goods is typically done in jurisdictions different from those of the funds' origin. Although such transactions provide tokens of lavish and extravagant lifestyles, they also have a clear purpose: they allow dirty money to enter the legal market by converting it into seemingly "clean" assets. The process makes it much more difficult and cumbersome for tax and law enforcement authorities to detect, freeze and return the funds.

The reason why luxury goods are among the preferred methods for hiding the proceeds of corruption is quite simple: they provide "badges of wealth" and transfer the value of stolen monies into high-value assets such as real estate and jewellery. At the same time, these purchases often escape due diligence checks even in countries that require their non-financial businesses to comply with anti-money laundering (AML) regulations (see side bar). In theory, regulatory measures aim to find out the licit origin of the client's funds and to report suspicious activities like paying cash in full for expensive properties, cars and jewels.

Despite recent government attention to the problem of money laundering, suspicious activity reporting continues to be low in the luxury goods sector. Data from the European Union paints a disappointing picture: among all the suspicious transactions reported in 2010, only 0.04 per cent has been submitted by real estate agents and only 0.7 per cent by dealers in high-value items (0.03 per cent if the UK is excluded).<sup>2</sup> In Germany,<sup>3</sup> the UK<sup>4</sup> and Italy,<sup>5</sup> national reports reveal the same worrying trend: real estate agents and high-value dealers are reporting suspicious transactions at a miniscule level that does not correspond with the thousands of transactions that are occurring.

## CLEANING UP THE SECTOR

Although money laundering through luxury investments remains a great source of concern, there have been some positive advances multilaterally and by specific countries. The Financial Action Task Force (FATF) — the intergovernmental organisation that sets the global standard in anti-money-laundering policies — has issued 40 key recommendations which represent the main reference for policies to regulate the luxury goods sector. Recommendations include measures for so called "designated non-financial businesses and professions" to adopt the same AML obligations that currently apply to financial sector actors (see side bar). Corrupt figures often seek out the help of these professional intermediaries to launder their money through the luxury goods sector. The aim is to have this group adopt customer due diligence and record-keeping, implement internal AML programmes and report suspicious transactions (recommendations 22 and 23).<sup>6</sup> Compliance, however, remains low and patchy.

The third European Union (EU) anti-money laundering directive,<sup>9</sup> as well as its proposed successor, explicitly addresses selected non-financial businesses such as accountants, notaries and lawyers (when facilitating a transaction), real estate agents, casinos and traders in high-value goods. The latter category must complete due diligence on payments that are made in cash in an amount of €15,000 or more (the proposed new fourth directive will lower this limit to €7,500).<sup>10</sup> An even better approach is to require dealers in luxury goods to comply with AML obligations, independently of the nature of the payment, but based on the value of their saleable items. Dubai, for instance, requires all

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## DUE DILIGENCE

Due diligence is a phrase commonly used for doing proper checks on customers or investments to ensure that they do not present a risk to one's business, such as because of questionable sources of funding or links to corruption. Enhanced due diligence is "the term used to refer to Know Your Customer money laundering measures that include validation and documentation by third parties and applies to situations where higher risk clients and politically exposed persons such as senior politicians, are concerned".<sup>7</sup>

## LUXURY GOODS AND FATF

The luxury goods sector is often included as part of the category of "Designated Non-Financial Businesses and Professions" (DNFBPs).

Under regulations proposed by the Financial Action Task Force (FATF), this group of actors refers to a broad range of intermediaries that can be involved in money laundering: casinos, real estate agents, dealers in precious metals and stones, lawyers, notaries, external accountants and service providers which, as a business, offer to third parties services related to company set up, the provision of a registered business address, nominee directors or shareholders services, as well as trustees of express trust.<sup>8</sup>

In some jurisdictions, the category also includes dealers in high-value goods (resellers of luxury cars, yacht, artworks, etc.) or, alternatively, any trader accepting cash payments above a given threshold.

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dealers in goods worth US\$ 15,000 or more to be registered as a “designated non-financial business and profession” and to fall under AML rules.<sup>11</sup>

Individual countries have taken additional steps to counter the use of money-laundering through luxury goods and real estate. Switzerland, for instance, is planning to forbid cash payments of over US\$ 112,000 (100,000 CHF) for both immovable and movable properties.<sup>12</sup> Transactions above this amount will have to be processed through a bank rather than in cash.

In many of the countries where AML regulations have been extended to the non-financial business sector, consistent legal and enforcement loopholes prevent them from becoming an effective barrier to money laundering activities. In the UK, for example, under the Money Laundering Regulations 2007, real estate agents must complete due diligence on sellers, but not on buyers.<sup>13</sup> This constitutes a considerable loophole considering the risk of money laundering activities related to the purchase of real estate properties. It is crucial to address the implementation deficit by making non-financial professions effectively subject to AML obligations. This can be done by amending existing regulations, providing them with the necessary training to recognise red flags and introducing sanctions to deter subjects from failing to meet their obligations.

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## FOLLOWING THE TAX TRAIL

Exchange of information between tax authorities may be a precious instrument to detect laundered assets. When an investment in a luxury good such as real estate is made by a foreign buyer, the receiving country shall investigate whether the funds have been taxed in the country of origin. This will help ascertaining whether the funds have been obtained through corrupt or illegal activities: if they are, they have most likely not been taxed.

## RECOMMENDATIONS

### GOVERNMENTS MUST:

- Close existing legal loopholes that facilitate money laundering in the luxury goods business by amending their anti-money laundering regulations.
- Make dealers in luxury goods subject to the same AML obligations as financial institutions, including the identification and record-keeping of the identity of the customer or beneficial owner.
- Expand the categories of luxury goods dealers identified by FATF to include traders in goods whose value exceeds a given threshold, regardless of whether cash is used in the purchase.
- Regulate certain sectors, actors and activities as part of fulfilling anti-money laundering obligations. The scope shall be at the same level as set by the FATF.
- Ensure full compliance with existing anti-money laundering regulations where they already cover luxury good dealers.
- Increase financial intelligence, provide guidance to identify risks and recognise red flags, and introduce sanctions such as withdrawal of the licence (where applicable), financial penalties and incarceration to create a clear cost for actions.
- Minimise money laundering risks related to the purchase of luxury goods or real estate by requiring all high-net purchases to be processed through a bank rather than in cash.

### THE LUXURY GOODS SECTOR MUST:

- Adopt industry and sector-wide codes of conduct and ethics that address anti-corruption and anti-money laundering.

- Ensure all owners and employees are trained in their due diligence obligations and how to spot red flags for corruption.
- Establish internal monitoring systems to assess compliance with voluntary measures and regulations.
- Create whistleblowing and confidential reporting hotlines for staff who wish to report alleged breaches in due diligence obligations.

## CIVIL SOCIETY MUST:

- Demand that governments extend and implement FTAF regulations for the luxury goods sector in their country.
- Pressure luxury good brands and vendors to undertake proper due diligence and report any suspicious transactions.
- Call for stricter sanctions for luxury good brands and vendors that fail to comply with AML obligations.

## NOTES

<sup>1</sup> For more information, see: <http://watchdog-watcher.com/2012/05/21/globalizing-stolen-assets-greed-fear-a-taste-for-the-luxury-goods-of-the-west/>.

<sup>2</sup> Author's own calculations based on Eurostat, "Money laundering in Europe", 2013.

<sup>3</sup> German Federal Criminal Police Office, "Financial Intelligence Unit (FIU) Germany - Annual Report 2012". Available at: [www.bka.de/nr\\_195636/EN/SubjectsAZ/FinancialIntelligenceUnit/financialIntelligenceUnit\\_node.html?\\_nnn=true](http://www.bka.de/nr_195636/EN/SubjectsAZ/FinancialIntelligenceUnit/financialIntelligenceUnit_node.html?_nnn=true).

<sup>4</sup> NCA, "Suspicious Activity Reports (SARs) Annual Report 2013". Available at: [www.nationalcrimeagency.gov.uk/publications/94-sars-annual-report-2013/file](http://www.nationalcrimeagency.gov.uk/publications/94-sars-annual-report-2013/file).

<sup>5</sup> Banca d'Italia, "Rapporto Annuale dell'Unità di Informazione Finanziaria", May 2014. Available at: [www.bancaditalia.it/UIF/pubblicazioni-uif/Rapporto\\_UIF\\_anno\\_2012.pdf](http://www.bancaditalia.it/UIF/pubblicazioni-uif/Rapporto_UIF_anno_2012.pdf).

<sup>6</sup> For more information see: [www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf).

<sup>7</sup> See: [www.transparency.org/glossary#/enhanced-due-diligence](http://www.transparency.org/glossary#/enhanced-due-diligence).

<sup>8</sup> For more information see the FATF glossary, [www.fatf-gafi.org/pages/glossary/d-i/](http://www.fatf-gafi.org/pages/glossary/d-i/).

<sup>9</sup> Directive 2005/60/EC of The European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1402907512384&uri=CELEX:32005L0060>.

<sup>10</sup> Proposal for a Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. 2013/0025 (COD). Available at: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52013PC0045>.

<sup>11</sup> For more information see: [www.dfsa.ae/Pages/DoingBusinesswithDFSA/BecomingRegistered/DesignatedNon-FinancialBusinessorProfession/DesignatedNon-FinancialBusinessorProfession%28DNFBP%29.aspx](http://www.dfsa.ae/Pages/DoingBusinesswithDFSA/BecomingRegistered/DesignatedNon-FinancialBusinessorProfession/DesignatedNon-FinancialBusinessorProfession%28DNFBP%29.aspx).

<sup>12</sup> "Verbot von Barkäufen über 100'000 Franken", *Neue Zürcher Zeitung*, 20 February 2014.

<sup>13</sup> For more information see: [www.hmrc.gov.uk/mlr/estate-ag-bus.pdf](http://www.hmrc.gov.uk/mlr/estate-ag-bus.pdf).

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