

ML Typologies through Real Estate Sector

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Introduction

Typologies, summarized by State Committee for Financial Monitoring of Ukraine, taking into account detected by itself, as well as law enforcement and other competent state authorities-participants of national AML system, related to real estate market, used by criminals or criminal groups for ML of the proceeds from crime.

The overall objective of this report is to develop more information on this issue and present a clearer picture of the way how real estate activity can be used for money laundering or terrorist financing.

The typologies aim to accomplish two primary goals:

- research of the means by which illicit money is directed and legalized through the real-estate sector;
- develop recommendations for detection and prevention of cases of legalization of the proceeds from crime through the real estate market.

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.

It is well-known that "dirty" money can be easily concealed in various legal transactions and real estate market makes no exception. Ukraine has implemented international standards in AML/ATF sphere mainly within financial sector, which includes banks, credit unions, insurance companies etc. As a result, currently we can name a trend of gradual transfer of illegal activity to relatively low-risk of detection spheres.

For conduction of transactions with real estate involving real estate agents or agencies, notaries etc. on legal basis is obligatory, but existing legislation that relates to these categories of transactions contains no obligations of reporting to SCFM of Ukraine. That is why designated activity field is very attractive for ML.

Real estate agents or agencies and notaries are key participants of transactions, conducted on real estate market, this is why necessity of legal regulation of considering such participants reporting entities arises.

For abuse on real state market criminals use various methods and tools, most of which can be referred to as absolutely legal, but using illicit funds.

Fraud in real state sector increase in quantity further more. Criminals are laundering money using transactions with purchasing and selling real state objects, investing in building construction, illegally possess real estate etc.

As a rule, such ML transactions have international nature. Professional criminals conduct them internationally not only for the reason of desiring to conquer more developed markets, but also for the risk to be detected decreases.

ypology specifies some signs of conducting high-risk real estate operations, that might speak for possible conduction of ML/FT or related to such actions. These signs of risk may assist to reporting entities in classification of certain types of real estate transactions in frame of proper vigilance while analyzing risks of new and existing clients, law enforcement entities during investigations, as well as other state authorities, participating in national AML/CFT system.

Fraud in Real Estate Sector

Crimes, involving real estate are subject to wide variety of sections and articles of Criminal Code of Ukraine. Among other real estate related crimes the most wide-spread is fraud (Article 190 of CC).

- General fraud scheme on real estate market is following:**
1. Search of victim;
 2. "Processing" of victim;
 3. Initial expropriation;
 4. Final expropriation.

1. Search of victim

Information on persons from the "risk group" is collected with an assistance of state authorities, that keep relevant records (district municipalities, registration offices, police, inventory bureaus, social services, hospitals), or with an assistance of non-state entities, that sometimes even pretend to be "charitable" (for instance, free dining-rooms for homeless etc).

2. "Processing" of victim

First way – victim is visited by "charitables" and get entrusted, second way – brutal force: kidnapping, welding, forced signing the documents etc.

3. Initial expropriation

First purchasing is conducted by member of group, so called "first gasket" – these are people that have nothing to lose.

In case of appearing of relatives, pretending to the apartment, or owner "came to sense" – the "second gasket" is used, that purchases apartment from the "first gasket".

This is, as a rule, member of lower echelon of criminal group, not "exposed" in police. That is the one, having look like purchaser acting in good faith. Though, he buys the apartment using letter of attorney and pretends "naïve and trustful" For the time court matter is considered (this can take years) real state is being used to get maximal benefit. Out of cases revealed: in such apartments are organized brothels, trans-shipment points for illegal migrants, drug dens – anything that can make a good income. Thus, the apartment is used to grant all benefits possible for the short term and organize delays (people desiring to get their apartment back often have no sufficient funds to take part in court hearing and hire lawyers)

4. Final expropriation

In case after initial expropriation it is cleared up that victim was right to choose (no one has protected

the victim, no relative of victim has appeared, and, consequently, no complaints are written), or victim has failed to continue opposing to criminals – apartment is reselled to “purchasers acting in good faith”, that are usual buyers.

Part of funds, received from selling illegally possessed real estate is utilized for financing further criminal activity.

Example I[1]. Fraud with real estate

Fraudsters fabricated passports, testaments, notarized documents, re-registration of real estate to oneself and acquaintances – for the reward. Victims were selected on one basis – socially unprotected.

Illegally gained property criminals legalized with reselling by men of straw to third parties – acting in good faith. As for the actual owners – they were taken aboard by fraudsters, being promised of job or reward. In this way victims got a long way of their home city – at the territory of Russia or Belarus, while criminals could freely complete the fraud operation. Or, for instance, there were produced death certificates or other documents, by which the mentioned persons dropped out of sight.

This real estate was being reselled and reregistered several times, while people in fact did not suspect what happens to their apartments.

It is important to note that not only realtors and notaries appeared to be, but also divisional inspectors, that acted in first place as “tipsters-off” and who know well which of inhabitants are alcohol/drug addicted or got into a scrape by losing job, experienced a family drama or was left single

Predicate crime: fraud in especially large sizes or by organized group.

II. “Building Frauds”

Situation on real estate market during last years remains relevant.

Usually fraudsters act according to the following schemes.

A company gets land plot in use and imitates launch of process. At the same time, advertising campaign, proposing to buy apartment in newly-erected building for the below-market price is held. Funds of individuals, received from such sells, are used, as a rule, for personal enrichment of business heads, but not for building construction. When the necessary sum is collected, construction company simply disappears.

One of options of such scheme realization – is using co-investing entities. As an example, company compiles agreements with co-investing entities, according to which it involves, on their behalf and their cost, funds of individuals, as well as agreements with builder entity for investing funds into several objects at a time. Having found share-holders and collecting their funds, company disappears. Thus, swindling both building entity and share-holders.

Also in such schemes targeted bonds are used. The point of scheme is that investors get securities in exchange for putting funds in construction. Interests of apartment purchasers, buying targeted bonds at the stage of constructing are at one side secured, as every bond issue is registered by the Securities and Stock Market State Commission.

But, as practice shows, returning funds having such securities is almost impossible.

ExampleII[2]

Joint-stock company “A” acted as a customer while constructing multi-storied building in Kiev. The funds, almost UAH 2mln. (\$400 thousand), collected from individual investors, were in fact misappropriated by director general of the designated company by abusing his position. 54 persons were claimed victims in this criminal case.

As a result, the criminal case against director general of the mentioned company was initiated. In April 2008 he was charged of committing a crime, sanctions for which include up to 12 years of imprisonment. By court decision, as cautionary measure for the accused was chosen taking the written undertaking to leave the place, but he did not show up as requested by investigator, so in August 2008 he was officially announced runaway.

Predicate crime: acquisition and embezzlement of one's property.

Example III[3]

In Kiev a private enterprise, that had been collected investors funds during 2 years for dwelling construction used to function. During this period around of 12mln hryvnas (\$ 2.4mln) were collected. As a result, frauds have misappropriated investors funds for the sum of over 11,5mln hryvnas (\$ 2,3mln).

Prosecution office has initiated the criminal case on the given fact suspecting crimes, specified by Article 190 and p.2 of Article 364 of CC of Ukraine (fraud and abusing power or one's position).

Predicate crime: fraud and abusing power or one's position.

Main groups of ML methods, used in real estate include:

- Use of fictitious agreements with real estate.
- Use of complex loans or credit finance.
- Use of non-financial professionals.
- Manipulation of the appraisal or valuation of a property.
- Use of monetary instruments.
- Use of "technical" ("trash") securities.
- Use of mortgage schemes.

III. Real Estate Fictitious Agreements

Such schemes, in most cases make only parts of more complex schemes and are used at the first stage of laundering – allocation of dirty funds. Also – for giving such funds a legal look.

Obligatory condition for realization of this scheme is fabricating documents related to the object of agreement.

Scheme Essence

Illicit funds gain legal form of payments on real estate agreements.

Laundering the proceeds from crime is conducted by fictitious selling of real estate.

Example IV[4]. Use of fictitious real estate operations

Mr. C residing in Ukraine has received to his account in Ukrainian bank over 7 mln. hryvnas from enterprise-resident of Ukraine allegedly for selling house he possessed.

While carrying out more precise analysis, it was discovered that passport, presented on behalf of Mr. C while both conducting purchase agreement and transferring money, was claimed lost.

As it was additionally determined in State Register of real estate property rights – there was found no information about Mr. C's ever possessing a real estate.

Also no information about registration of property rights for the purchased real estate by Ukrainian resident was found.

Considering the received information on absence of any real estate, privately owned by Mr. C, there are

reasonable grounds to believe that **funds**, received by the mentioned person from **enterprise, are illegally acquired**.

Possible suspicions:

- use of lost, fabricated person ID.
- origin of funds, involved in real estate operations is unknown;
- the customer is entity with insignificant activity period (as a rule such term is under 3 months since registration);
- real estate purchasing agreement is absent;
- property rights for the object of purchasing are absent;
- information in purchase agreement is inconsequent or inadequate;
- purchase agreement is legally incapable.

Instruments:

- wire transfers;
- fictitious real estate transactions;
- lost, fabricated person's ID.

Mechanisms and methods:

- client bank accounts, involved in fictitious real estate transactions.

IV. Complex Loans and Credit Finance

The widespread way of increasing company's circulating funds is capital resources intake, out of which receiving a loan from other company is very popular. Such loans are also generally used at real estate market as abusing such loans is used by criminals for legalization proceeds from crime.

There you may find the following schemes of such abusing.

1. Loan-Back Schemes

Such transactions are used by suspected criminals to buy properties – either directly or indirectly – through the purchase of loan securities. Essentially, suspected criminals lend themselves money, creating the appearance that the funds are legitimate disguise their origin.

Scheme Essence

Criminal proceeds are transferred, as well, across countries borders, and are respectively legalized in form of loans between companies, registered in different jurisdictions. Further funds are invested in real estate.

Later on, under the pretence of credit payments funds can be again used for financing criminal actions.

ExampleV[5]

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: **TCSP**). 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.

Thus, the given companies were used for disguising person of owner, as well as for allocation of proceeds from crime. These companies were those that conducted emission of bearer securities, whose owner was _____ respectively _____ Mr. _____ X.

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 counseling activities. Mr. Y opened accounts on behalf of Company C in the bank of certain European country.

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. Due to such scheme the criminal funds was initially accumulated on the account of Company A via cash deposits. Using Companies B and C to provide loans the funds were at last invested to real estate in Europe that enlarged the legal activity of Company C.

Company C periodically made a repayment of principal and interests of the loan to the Company B, which in its turn executed the same transaction with Company A. The funds received by Mr. X were used for financing of its criminal actions and were deducted from taxation.

It should be noted that a criminal funds were problematically detected as Mr. X mixed the criminal funds from illegal drug trading and legitimate funds from legal activity of Company C.

Predicate crime: illegitimate sale and distribution of drugs.

Possible suspicions:

- 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;
- Disguise the owner through bearer securities and usage of trust;
- The lender of the money 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.

Instruments:

- loan;
- wire transfers;
- real estate.

Mechanisms and methods:

- companies located in high ML/FT risk countries, particularly, in offshore jurisdictions and jurisdictions with strict bank secrecy;
- business accounts opened in banking institutions located in high ML/FT risk countries, particularly, in offshore jurisdictions and jurisdictions with strict bank secrecy;
- company registered on front person;
- business account registered on front person;
- usage of trust and bearer securities on purpose to disguise the owner;
- purchase of real estate;
- mixing "criminal" funds from illegal selling drugs and "clean" funds from legal activity of company, proceeded on purpose to complicate the scheme revealing.

2. Back-to-Back Loan Schemes

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.

In some cases participating of financial institution employees is possible that is accompanied with submitting unauthentic information for receiving the credit.

Such scheme as usual is revealed by banking institutions during analyses of condition and dynamic of banking accounts as well as during financial analyses. There is sufficient possibility to reveal the scheme while proceeding visiting inspection by the regulating and supervising authority, studying financial transaction by SCFM of Ukraine or providing operational inspections by law enforcement authorities.

Considering large amounts of funds that could be legalized, this scheme can be rather dangerous. Usually it is closely related with using different mortgage objects, such as bank metals, securities, property rights, etc. On purpose to complicate the scheme, the mortgage object can be located not in crediting bank but in other financial institution abroad.

This scheme sets special danger if there is a plot between offenders and bank employees. In this case, forgery of credit documents, mortgage documents, etc, is possible. Revealing such scheme, the bank can lose the reputation.

Scheme Essence

The person places the funds from illegal activity on deposit account in bank. Further he receives the credit cover for which is deposit funds.

This person makes no payment under this loan, and the mortgage object passes to the creditor.

ExampleVI[6]

Mr. X was a criminal who established Company A in offshore jurisdiction. Mr. X was the owner of Company A, did not want to disclose his identity and thus used a trust company as legal representatives.

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, Mr. X set up a **back-to-back loan** structure to use his criminal money to invest in real estate.

Further, Mr. X placed proceeds from crime to the account of Company A and provided concluding loan agreement between Company B and bank located in the same jurisdiction under the mortgage of Company A funds.

Mr. X provided concluding the agreement on bank guarantee between two banks. So bank located in offshore jurisdiction was ready to provide bank guarantee with mortgaged deposit of Company A.

According to the conditions of loan agreement, if Company B was unable to repay the principal and interest, the bank which provided the loan could use the money pledged on deposit account of Company A in the banking institution located in the same jurisdiction with Company A to settle the payments

The received loan 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.

After a period of time, Company B stopped the payment of the principal and interest. Bank, which provided the loan, used the pledged deposit to settle the payments.

Possible suspicions:

- Source of funds involved in transaction on real estate is unknown or locates abroad, including high ML/FT risk countries, particularly, in offshore jurisdictions;
- No reference in the loan agreement to the underlying collateral;
- The collateral provider and other parties involved in the loan structure were not known;
- Disguise the owner, particularly, provided through usage of trust;
- The borrower of the money was not willing to provide information on the identity and background of the collateral provider;
- The complex nature of the loan scheme could not be justified;
- There was an unexpected loan default.

Instruments:

- loan;
- wire transfers;
- real estate;
- mortgage.

Mechanisms and methods:

- companies located in high ML/FT risk countries, particularly, in offshore jurisdictions;
- business accounts opened in banking institutions located in high ML/FT risk countries, particularly, in offshore jurisdictions;
- company registered on front person;
- business account registered on front person;

- purchase of real estate;
- usage of trust on purpose to disguise the owner.

3. Schemes of illicit Misappropriation of Plots of Land by Nonresidents

Scheme Essence

The essence of such schemes consists in receiving the credit funds for financial – economic activity by residents of Ukraine from nonresidents. The resident buys land plots for received from nonresident funds, and the credit funds won't be returned.

According to the legislation of Ukraine, nonresidents shall not have the right to be the owners of agricultural land in Ukraine.

But, in accordance to the legislation of Ukraine, in case of inopportuneness or impossibility to return the credit, any kind of real estate can pass to the nonresident's ownership.

Thus, the certain conditions are established for illicit appropriation of the land in Ukraine by the certain nonresident that gives the opportunity to avoid the direct legislative regulations which prohibits nonresidents to own agricultural land plots.

Example VII[7]

Newly established Ukrainian enterprise receives from **newly established nonresident** of Republic of Cyprus – the credit on the amount of **USD96,68 mln (UAH 389,68 mln)**.

The directors of Cyprus company, as revealed during investigation, are citizens of Ukraine.

Received from nonresident funds were transferred on the account of **5** natural persons for land plots on the total amount of **USD 75,03 mln**. Natural persons sold **33,92 hectares** of agricultural land.

Moreover, was established that **2 natural persons** are persons related to allotment of land of regional administration on territory of which the sold lands are located. In this case the "corruption" actions of regional administration officials are watched.

ExampleVIII[8]

Regional administration allotted **90 hectares** of land for creating gardening society participants of which were about 500 students. As it were revealed further, noted students were dummy owners of land plots.

Under purchase (sale) agreements students submits property rights for land plots through the number of natural persons to the 4 natural persons.

Noted 4 persons sold land plots to the limited liability company "A" for **UAH 191 mln (USD 38,2 mln)**, and received funds put on deposit accounts and use for private purposes, purchase real estate and other property.

Providing investigation it was established that limited liability company "A" received the credit on the amount of **UAH 212 mln (USD 42,4 mln)** for building cottage town, and there were no changes in land purpose on any stage of executed transactions. The guarantee for credit at the bank was natural person – nonresident of Ukraine.

ExampleIX[9]

The legalization (laundering) of the proceeds from crime fact was fixed executing purchase (sale) of land plots.

Under falsified decision of City Council there was allotted and registered on dummy natural persons land plots for the total square of **36 hectares** for building and servicing individual living houses, housekeeping buildings.

After that mentioned plots were reregistered under purchase (sale) agreements on a number of legal and natural persons.

Further, mentioned legal and natural persons sold their land plots to another citizen for **UAH 40 mln (USD8 mln)**, who sold them to the company under nonresident of Ukraine control (Geneva, Switzerland) for **UAH 325 mln (USD 65 mln)**.

Part of received funds this citizen legalized in Ukraine using for purchase the real estate in Kyiv and investing in building the luxury dwelling, and the rest took in cash in one of the commercial banks.

Possible suspicions (Examples VII, VIII та IX):

- source of funds involved in transactions with real estate is unknown or locates abroad;
- newly established enterprise was establish only for purchasing land plots and provided no other economic activity, and is under control of nonresident;
- participants of the scheme are legal persons with short period of activity (as a rule, it doesn't exceeds 3 months form state registration);
- providing purchase (sale) of land plots for prices essentially different from real prices;
- no executing of the loan conditions, in particular, sudden suspending of payments for general amount of loan and interest;
- participants of the scheme are natural persons, including founders of legal persons the age and/or physical condition of which can evidence on impossibility of providing active entrepreneur activity (age under 25 or exceeds 70).

Indicators and methods identified in the scheme (Examples VII, VIII and IX):

Instruments:

- loan;
- wire transfers;
- land plots;
- mortgage – the property of company – loan receiver including purchased land plots.

Mechanisms and methods:

- newly established companies with indicators of fictitious nature;
- dummy persons;
- notary which provides concluding agreements on submitting property rights on land plots.

V. The Role of Non-Financial Professionals

In the result of SCFM of Ukraine and entities of national AML system activity the certain experience on efficiency of revealing ML schemes is received.

As a result, the offenders attempt to adapt their methods to new conditions and the ML schemes become more complicated.

Also the international experts mention this fact and accent that instead of direct placement funds into

the banks the offenders hire the professionals for laundering (lawyers, notaries, accountants, auditors of companies and other professionals), who can assist in placing illicit proceeds into legal financial systems. Such persons are involved to establishing and improvement the ML schemes, aimed at unnoticeable transferring of illegally received funds.

Such trend also is present in the real estate market.

1. Disguise of offender

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.

Example X[10]. Misuse of a real estate broker

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

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 to FIU.

Following the detailed analysis of the FIU detected that one of the members of the board of the trust was found to be related to a bank with suspected links to a terrorist organization.

Possible suspicions: use of trust and non-financial professional is provided on purpose to disguise the real owner.

Indicators and methods identified in the scheme:

Instruments:

- real estate;
- loan.

Mechanisms and methods:

- non-account holder customer – natural person intermediary;
- offshore customer – high ML/FT risk trust company;
- real – estate agent.

2. Notaries

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 ML/TF.

Until lately, however, these professionals have not been obligated under international standards to report suspicious activity to their national financial intelligence units (FIUs).

At the same time, international experience shows that their role in suspicious activity detection may be significant.

Besides, notaries may detect false data in signed property conveyance documents on persons conducting transactions as well as on the subject of agreement.

However, in Ukraine the process of engaging the above mentioned non-financial professions in providing FIU with suspicious activity reports is on conceptual stage now.

Example XI[11]

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.

Such funds were used to purchase the real-estate. The funds were transferred 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.

Possible suspicions: 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.

Instruments:

- wire transfers;
- real estate.

Mechanisms and methods:

- business account, owner – natural person, mediator;
- offshore client – trust company, posing maximum ML/TF risk;
- real estate purchase;
- notary.

Example XII[12]

Non-resident of Belgium was introduced by lawyers in the bank so to open the account. Remarkable sums of money were placed on account from unknown person. This money was used to purchase real estate in Belgium. Within one of payments group of foreign investors established certain complex structure.

Information provided to FIU by notary's office showed that two holding companies were established by four foreign companies with help of this notary's office in Belgium. Besides, these two holding companies established in Belgium two more companies functioning on Belgium real estate market. Company's representatives (a lawyer and a diamond dealer) were intermediaries of those companies investing real estate. They were persons of straw and act on behalf of foreigner. Moreover,

layer representing person's interests in bank was involved in committing similar crimes before. It also turned out, that address of the company registered in Belgium and address of layer's office coincide. Thus, lawyer established nonresident ML scheme investing money in real estate projects in Belgium.

Possible suspicions:

- source of funds involved in operations with real estate is unknown and is located abroad;
- participants of the scheme are companies working with intermediaries – men of straw;
- transactor 's personal data coincidence (in this instance – organization's location address);
- lawyer is used to create a ML scheme.

Instruments:

- wire transfers;
- real estate.

Mechanisms and methods:

- lawyer – here main participant of ML scheme;
- companies working only with intermediaries;
- real estate purchase;
- men of straw.

3. Trust Accounts

A trust account[13] 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.

Example XIII[14]

A verification of natural person revealed that a lawyer was involved in ML through property and other transactions. The lawyer organised conveyancing for the purchase of residential property and carried out structured transactions (smerfing) in an attempt to avoid detection.

The lawyer established trust accounts for the natural person and ensured that structured payments would be used to purchase properties and pay off mortgages.

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

Possible suspicions:

- to purchase the property and pay off mortgages, and bearer shares were made knowingly in order to avoid detection of beneficiary;
- funds were transferred in small sums to avoid identification;
- source of funds is unknown or is located abroad;
- cash payments.

Instruments:

- structured cash transactions;
- real estate.

Mechanisms and methods:

- establishment of trust accounts to purchase properties and pay off mortgages;
- purchase of property in the names of the main target.

VI. Manipulation of the Appraisal or Valuation of a Property

Manipulation of the real value of property 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, sport clubs criminals use such method which facilitates the manipulation with property market value.

Scheme Essence using speculation operations in real estate trade

Intermediary was using ML funds to buy an object, after that he resold it to other involved person for considerably higher price. In other words, intermediary received profit and legalized proceeds from crime.

Distinguishing feature of this type of scheme can be a succession of sales and participation of fictitious "transit" companies. At the same time falsification of real estate evaluation documents and sale-purchase agreement can be performed.

As a rule, those schemes are only a part of more complicated scheme and are used for legalization.

Usually schemes are exposed while comparing object's real and market value, and learning subjects of resale (identification of operation recurrence).

1. Over-valuation or Under-valuation

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.

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 conceal the "dirty" finds and conceal their origin.

Method of real estate objects valuing in sale-purchase agreement is also widely used. In other words, price indicated in purchase contract is lower than one that should be paid. Disparity in price is paid off-the-record from funds proceeded in crime.

Then real estate is sold at the common rate providing legalization of money proceeded in crime.

Example XIV[15]

A remarkable sum of money (hundreds of thousands dollars) were placed on **Mr. K's** account, citizen of USA resident in Ukraine. Stated funds were received from abroad from foreign citizen **Mr. T.**

According to information from foreign competent authorities, **Mr. T** was engaged in illegal drug trafficking and ML on international level. While **Mr. K** Left USA in order to avoid punishment.

Mr. K spent received money to purchase apartments. Besides, **Mr. T** was former owner of some of them.

Apartments went on a succession of sales at considerably different prices (overvalued or undervalued). Moreover, while a resale of one of apartments by **Mr. K**, sale-purchase agreement contained false data on agreement object.

Predicate offence: illicit sale, drug trafficking.

Possible suspicions:

- source of funds is unknown or is located abroad;
- participant of the crime scheme was brought to criminal liability;
- participants of cross-border transaction have no direct connections;
- sale-purchase transactions of one real estate object are performed within short period of time;
- resale of real estate by overvalued/undervalued prices are performed to provide legal origin of funds;
- information provided in sale-purchase agreement is inconsistent, incorrect or false.

Instruments:

- real estate;
- wire transfers.

Mechanisms and methods:

- account opened in banking institution containing money received from abroad;
- real estate sale-purchase agreements concluded by notary.

2. Successive Sales and Purchases

In the case of successive sales and purchases, the property is sold in a series of subsequent transactions, each time at a higher price.

Example XV[16]

A lawyer created several companies (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 transfers the 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.

After investigation it was detected 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.

Predicate offence: illicit sale, drug trafficking.

Possible suspicions:

- source of funds engaged in performing real estate operations are either unknown or situated abroad, including countries posing maximum ML/TF risk, offshore jurisdictions in particular;
- continual land costs growth;
- 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.

Instruments:

- loan;
- wire transfers;
- real estate;
- bribery.

Mechanisms and methods:

- front company customers, registered in offshore jurisdiction;
- lawyer;
- companies business accounts.

Typology VII: Monetary Instruments

The use of monetary instruments in real estate transactions has traditionally dealt primarily with the use of cash despite the improvement of settlement forms.

Other monetary instruments that can be used by criminals in their real-estate activities are cheques and wire transfers etc.

1. Cash

The purchase of high-value properties in cash is one way in which large sums of money can be integrated into the financial system.

Example XVI[17]. Use of cash to buy real estate

International criminal organization operating in the Americas and Europe, laundered funds generated from drug trafficking through the misuse of financial institution and exploitation of apparently legitimate real-estate businesses in different countries.

The criminal organization led by Mr. B, sent cocaine from South America to Europe, disguising it in rubber cylinders.

Some money from cocaine forwarded in the same way back across to the South America to finance further illicit actions.

In Latin-American Country 1, Mr. B acquired an existing financial institution; he changed its name and became its main shareholder and general director. With the purchase of an already constituted

financial institution, the criminal organization 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 organization acquired commercialization 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 financial institution in Latin-American Country 1.

The ground for transferring funds was the investment into real estate sector.

Intelligence information revealed that the account of the financial institution, received during a year and a half period, deposits for more than USD 160 million.

Predicate offence: illicit sale, drug trafficking.

Possible suspicions:

- origin of cash, flowing to accounts of companies, whose primary activity was trading precious stones and real estate brokering, is unknown;
- companies do not conduct actual financial activity.;
- cash flowing to accounts of companies, whose primary activity was trading precious stones and real estate intermediation, followed by its immediate transfer abroad;
- cash in-flow in small banknotes;
- cash transferred to accounts of one single financial institution;
- use of outbid bought financial institution was made on one single purpose – to avoid strict control of controlling authority.

Instruments:

- wire transfers;
- cash;
- real estate.

Mechanisms and methods:

- outbid financial institution;
- companies, whose primary activity was trading precious stones and real estate brokering;
- bank accounts of the companies.

2. Cheques and Wire Transfers

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.

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.

Example XVII[18]. Use of a transit account to buy real estate and launder the funds from human being trafficking

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. (

The detailed analysis showed that the account had been used as a transit account by other Asian nationals for the purchase of real estate and the funds origin from human trafficking.

Predicate offence: human trafficking.

Possible suspicions:

- origin of money placed into account is unknown;
- source of funds origin is abroad;
- placement of funds in cashless form and withdrawal from the account of a natural person with a payment designation not related to usual activities of this natural person;
- the amounts the financial transactions involve donot correspond to financial state of the customer;
- the account is used exclusively as transit one – to purchase real estate.

Instruments:

- wire transfers;
- real estate.

Mechanisms and methods:

- notary;
- bank;
- personal account.

Example XVIII[19]

This example concerns import of 24 kg of heroinhidden in the cargo. The case was initiated aft erdetecting suspicious flows (to the amount exceeding 25 mln of Australian dollars) from Australia to the countries of Southern-Eastern Asia using smerfing. Wire transfers and bank checks were ordered on behalf of the syndicate.

Bank checks received from different financial institutions of Southern-Eastern Asia were later used to buy real estate in Australia.

The syndicate used lawyer's services to open bank account and register the company. The lawyer also provided the management of the company with the services of investment character. Moreover, the syndicate involved trustees to buy property abroad using bank institutions (funds were transferred to the trustee through a transit account).

Predicate offence: drug trafficking

Possible suspicions:

- origin of funds is unknown;
- source of origin of funds is abroad;
- conscious conducting of structured transactions (smerfing) in order to avoid disclosure;
- using lawyer's services to create money laundering schemes;
- the account is used exclusively as a transit – to invest money of illicit origin into reliable branches of economy.

Instruments:

- wire transfers;
- bank checks ;
- real estate.

Mechanisms and methods:

- notary;
- customer's bank account;
- trust account;
- structured transactions (smerfing);
- trustees.

VIII. "Technical" ("Trash") Securities

Technical ("Trash") Securities are used as a main instrument in money laundering schemes and transfer of funds in foreign currency abroad.

Under the results of monitoring of the transactions with securities, including transactions with participation of non-residents, it is possible to make the conclusion that approximately one third of all transactions is conducted with the securities of stock companies established through reorganization of limited liability partnerships, and the statute funds of which were formed with securities and other cashless funds. Such stock companies are fictitious. Their establishment is aimed not at attracting investments to undertake business activities but exclusively at issue of securities used to speculate in the stock exchange market and in money laundering schemes.

Example XIX[20]. Illicit acquisition of real estate and its further legalization using technical "trash" securities.

To sell real estate that belongs to close corporation **T**, its chief executive officers together with controlled company-non-resident establish close corporation **C** with a legal address under the place of location of close corporation **T**.

The statutory fund was formed, and its parts were distributed between the founders in the following way:

Statutory part of close corporation **T**- real estate objects, that were on the balance of this company (warehouses and administrative buildings) to the total amount of **UAH 1,33 mln.** (\$ 266 000);

Statutory part of non-resident company – shares of Ukrainian enterprise (open stock company **K**) to the total amount of **UAH 4,03 mln.** (\$ 806 000).

There are grounds to believe that the shares of company **K** are fictitious for open joint stock company was established through reorganization of Limited Liability Company and has only two founders – private enterprises with the signs indicating that they are fictitious (annulled certificates of VAT payers). Statutory parts of these enterprises constituted **UAH 17 mln** (\$ 3,4 mln.) та **UAH 51 mln** (\$ 10,2 mln.).

Under the results of inspection it was clarified that close corporation **T** and the company non-resident concluded the agreement of exchange under which trash shares were swapped on the ownership rights for immovable property of company **T**. Moreover, this property was greatly underestimated.

After receiving control of real estate, CEOs of **C** take the decision to liquidate the enterprise and sell the shares (property) to the enterprise **D**. Therefore, this scheme includes:

- using “technical” securities by non-resident to receive ownership rights for immovable property in Ukraine;
- inflicting great damages to the stock-holders of the company **T** for alienation of the property was carried out without appropriate stock-holders meetings;
- registration of company **C** was performed with the only aim – to conduct the transactions on shares-ownership rights exchange;

Predicate offence: malfeasance, fraud

IX. Mortgage Schemes

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 such products. Through this misuse of the mortgage lending system, criminals mislead the financial institution into granting them a new mortgage or increasing the amount already lent. Usually such schemes are conducted by financial institution employees.

It was observed in many instances that financial institutions consider these mortgage products to be low risk.

1. Mortgage Loans

In such schemes criminals obtain mortgage loans to buy properties. Later, in many instances scheme organizers use illegally obtained money in a different way.

Front men are also sometimes used to buy properties or to apply for mortgages from financial institutions. On occasion the property could be used for criminal activities for example, selling or storing drugs, hiding illegal immigrants, human trafficking, providing a safe house for members of the organisation, etc.

Example XX[21]

Mr. X was the owner of Company A which had some low-profile activities in managing and exploiting properties. The property managed by Company A was used for activities by other companies owned by Mr. X (for storage, for example).

Mr. X hired Mr. Y as **front man** of Company A by authorising him for managing Company A.

Mr. Y set up a relationship with European Bank that provided for accounts and payment services.

Mr. X. planned to buy office buildings for EUR 8 million 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 million).

Based on the assessment, European Bank was willing to grant a mortgage of EUR 13 000 000.

After bank transferred funds under the loan agreement on administrative buildings, Company A accordingly received additional EUR 5 million for their renovation.

Mr. X 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 European Bank was presented to the foreign banks as the legitimate source of the funds that were being transferred to the accounts.

The renovation of the office buildings never took place. Meanwhile the activities of Company A rapidly decreased. Company A finally went into default. European Bank 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.

Predicate offence: forgery, deception, fraud, money laundering.

Possible suspicions:

- Applying for a loan under false pretences;
- Using forged and falsified documents;
- The loan amount did not relate to the value of the real estate;
- Immediate transfer of credit money abroad.

Instruments:

- loan;
- counterfeited documents;
- real estate.

Mechanisms and methods:

- real estate agency (agent);
- bank;
- collusion;
- front man or trustee.

2. Over-valuation of Real Estate

Also you may find cases for over-valuation of real-estate. This is quite clear as the loan object is big so you can get 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 centers, restaurants, unique buildings, etc.

While applying for a mortgage, the front man and false documentation are widely used. When the bank tried to recover the debt from the front-man, it found that the latter did not know who was really a beneficiary.

Example XXI[22]

Director of one shopping mall came to an agreement with the manager of one of Ukrainian banks and created the system of obtaining credits through trustees. The fraudsters received mortgage credits under the property evaluated by the real estate agency controlled by them. The price of the mortgage appeared to be overvalued **20 times** in comparison with a real price. During several years these persons acquired through fraudulent actions the resources worth **UAH29 mln** (\$ 5,8 mln.). The criminals transferred the proceeds from crime to the account of fictitious firms.

Possible suspicions:

- the persons that applied for a mortgage loan do not undertake or undertake insignificant business activities;
- provision of false documentation to obtain loan;
- provision of false documentation regarding value of the mortgage;
- immediate transfer of credit funds to the accounts of fictitious firms.

Instruments:

- loan;
- collusion with bank officials;
- real estate.

Mechanisms and methods:

- real estate agency (agent);
- bank;
- counterfeited documents;
- false value of the mortgage;
- fictitious firms;
- front man or trustee.

X. Real Estate ML/FT Financial Transactions Risk Criteria

To introduce objective risk-based approach, it is necessary to designate money laundering and terrorist financing risks assessment criteria.

ML/TF risks level can be evaluated using various categories. The most wide spread criteria are: country or territory, customer and products/services. The attention focused to these risk criteria (separately or together), while conducting general money laundering risks assessment may differ depending on the circumstances.

Thus is no list of risk categories, but the following are the most wide spread.

Country/geographic risk

Potential elements contributing to risk include:

- Location of property – object of the agreement.
- Location (registration) of the buyer and seller.

Factors that may result in a determination that a country poses a higher risk include:

- Countries subject to sanctions, embargoes or similar measures issued by, for example, the United Nations (UN);
- Countries identified by credible sources[23] as lacking appropriate AML/CFT laws, regulations and other measures;
- Countries identified by credible sources as providing funding or support for terrorist activities that have designated terrorist organizations operating within them;
- Countries identified by credible sources as having significant levels of corruption, or other criminal activity;
- Countries - off-shore territories;
- Countries where there is warfare;
- Countries where there is no mandatory registration of real estate;
- Countries that are producers, dealers or intermediaries in weapon trafficking.

Customer risk

The main customer risk categories are:

- Customers related to terrorist activity;
- Customers-non-residents;
- Customers working through representatives only;
- Politically exposed persons (PEPs);

- Customers where the structure or nature of the entity or relationship makes it difficult to identify the true owner or controlling interest;
- Customers undertaking intermediary or representative activity acting on behalf of their customers;
- Cash intensive businesses;
- Legal person with an insignificant period of activity (as a rule such term does not exceed 3 months from the day of registration);
- Charities and other non-profit organizations (except organizations under the aegis of well-known international organizations);
- The use of intermediaries who are not subject to adequate AML/CFT laws and measures and who are not adequately supervised.

Transaction risk

The main transaction risk categories are:

- Speed of the transaction (transactions that are unduly expedited without a reasonable explanation maybe higher risk), complex, extremely large transactions and unusual financial transactions;
- Type of properties (residential or commercial, vacant land, investment, high-turnover properties, multi-unit properties for lettings/leases);
- Successive transactions, especially of same property in short period of time with unexplained changes in value;
- Conversion of properties into smaller units;
- Introduction of unknown parties at a late stage of transactions, *e.g.* arrangements made between purchasers;
- Third-party vehicles (*i.e.* trusts) used to obscure true ownership of buyer;
- Under- or over-valued transactions;
- Sale of properties immediately before restraint or insolvency;
- Property value not in the profile of the customer;
- Purchase with large amounts of cash;
- Use of complex loans, or other obscure means of finance;
- Unexplained changes in financing arrangements;
- Unusual sources, *e.g.* funds obtained from unknown individuals or unusual organizations.

[1] Under materials of Ministry of Internal Affairs of Ukraine

[2] Under materials of Ministry of Internal Affairs of Ukraine

[3] Under materials of Ministry of Internal Affairs of Ukraine

[4] Under materials of Ministry of Internal Affairs of Ukraine

[5] *Source: Netherlands.*

[6] Source: Netherlands.

[7] Under materials of SCFM of Ukraine

[8] Under materials of SCFM of Ukraine

[9] Under materials of Security Service of Ukraine

[10] Source: Belgium.

[11] Source: Belgium.

[12] Source: Belgium.

[13] **Trust Accounts**, also known as earmarked account; escrow account; frozen account; temporally frozen account (on condition of delay or else) deposit account; qualified deposit target account.

[14] Source: Australia.

[15] Under materials of SCFM of Ukraine.

[16] Source: Spain.

[17] Source: Mexico.

[18] Source: Belgium.

[19] Source: Australia.

[20] Under materials of State Tax Administration of Ukraine.

[21] Source: Netherlands.

[22] Under the materials of State Tax Administration of Ukraine.

[23] "Credible sources" refers to information that is produced by well-known bodies that generally are regarded as reputable and that make such information publicly and widely available. In addition to the Financial Action Task Force and FATF-style regional bodies, such sources may include, but are not limited

to, supra-national or international bodies such as the International Monetary Fund, the World Bank and the Egmont Group of Financial Intelligence Units, as well as relevant national government bodies and non-governmental organizations. The information provided by these credible sources does not have the effect of law or regulation and should not be viewed as an automatic determination that something is of higher risk.