Gatekeepers Advancing Integrity and Transparency in Real Estate

OCTOBER 2024

Overview

The real estate sector, characterized by substantial financial transactions and complex ownership structures, faces significant risks from illicit financial flows (IFFs). These flows, which stem from activities such as money laundering, corruption, fraud and tax evasion (collectively known as financial crime), threaten economic stability and social equity. The United Nations estimates that money laundering alone results in an annual global loss of **$1.6 trillion, or 2.7% of the global GDP**.[1] This alarming statistic highlights the urgent need for strong defences against financial crimes.

As the complexity, scale and frequency of global financial crimes evolve, combined with increased regulatory scrutiny and enhanced obligations, it has become increasingly crucial for real estate companies, along with stakeholders across the capital stack – including investors, lenders, equity partners and asset managers – to enhance their safeguards against these threats. Here, safeguards are defined not only as technological measures, such as cyber defences and screening technologies, but also as cultural shifts within organizations. This includes change management efforts aimed at fostering a mindset where employees feel comfortable and responsible for asking for and verifying documentation. Effective safeguards address regulatory, financial, operational (including fraud and IT risks) and reputational risks.

The World Economic Forum's Partnering Against Corruption Initiative's[2] (PACI) workstream on Gatekeepers Advancing Integrity and Transparency (GAIT)[3] leverages the Unifying Framework[4] to introduce new opportunities for private sector professionals to combat IFFs, starting with the real estate industry. By providing sector-specific knowledge and resources, companies can advance integrity and transparency measures, which in turn helps build a foundation for a sustainable future, reduces inequality and ensures fair resource distribution.

Engaging in these efforts enables companies to collaborate with industry bodies to shape global and sector standards, showcasing their commitment to ethical practices. This not only builds trust with clients, investors and partners, but also integrates the fight against IFFs into sustainability strategies, demonstrating a commitment to responsible business.

Objectives

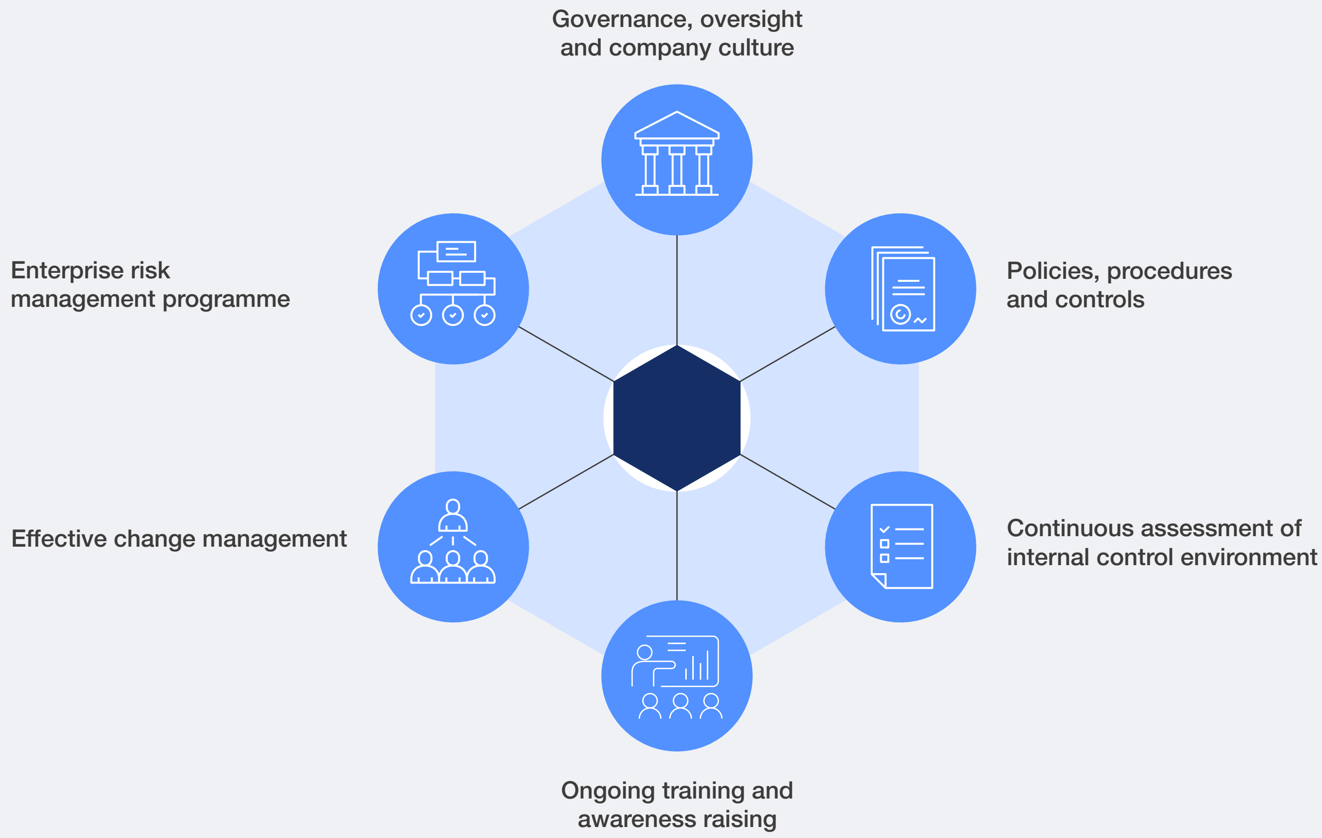
This paper aims to:

1. Equip real estate professionals with a comprehensive framework to support implementation standards and develop a risk-based approach (RBA). This approach is essential for effectively addressing current obligations and strategically navigating the rapidly evolving regulatory landscape.

2. Offer a detailed set of principles to assist the industry in identifying and managing specific risks inherent to the real estate sector. By adhering to these principles, real estate companies can foster a culture of integrity and transparency, safeguarding themselves against exploitation for illicit activities.

This paper presents a high-level framework that outlines key principles identified by PACI to enable real estate companies to enhance their defenses against illicit financial flows.

Six principles for fighting illicit financial flows in real estate



PRINCIPLE 1:
Governance, oversight and company culture

Effective governance and oversight are fundamental to combating illicit financial flows. This principle emphasizes the importance of strategic planning, objective-setting and goal alignment, ensuring governance structures robustly support anti-IFF strategies. A well-defined governance framework should include documented roles and responsibilities, designating qualified professionals and considering practical lines of defense, particularly for smaller organizations that may outsource audit functions. This framework ensures accountability for issues identified through self-assessment, regulatory findings, internal audits and operational monitoring.

Integral to this principle is the development of a strong ethics and compliance programme, incorporating mechanisms for external complaints, whistle-blowing and independent ombudsman services. Reporting obligations, both internal and external, are crucial for transparency and accountability. Clear escalation and change management procedures, coupled with collaborative communication across all organizational levels, foster a culture of integrity.

Additionally, adjusting the incentive systems to align with the corporate culture of integrity ensures that ethical behaviour is rewarded and reinforced throughout the organization. Active oversight by the board of directors and senior management, supported by regular compliance reporting, ensures continuous improvement.

Finally, the establishment of mechanisms for reporting and intelligence sharing with external agencies, regulators or enforcement agencies on suspicious transactions or activities, and adhering to anti-tipping off regulations, ensures a comprehensive response to these risks. Fostering collaboration through reporting and intelligence sharing with other professionals within a transaction or investment chain is crucial for maintaining transparency and accountability. When coupled with industry-wide collaboration through initiatives and partnerships, this in turn enhances governance and harmonizes efforts to combat illicit financial flows effectively.

PRINCIPLE 2:
Establishment of an enterprise risk management (ERM) programme

The foundation of combatting IFFs lies in establishing an effective ERM programme. A number of steps are required to establish such a programme – including defining, assessing and managing core risk categories through a clear methodology, depending on risk appetite and tolerance. Comprehensive risk assessments, including inherent risk analysis, control environment evaluation, residual risk output and post-assessment management, form the cornerstone of this strategy. Specific risks tied to illicit financial flows include money laundering, fraud, tax evasion, corruption and terrorist financing.

Additionally, risks that are often overlooked, such as trade-based money laundering, the use of shell companies, layering in real estate investments, concealment of beneficial ownership, and manipulation of property prices and cybersecurity vulnerabilities, must be addressed. For example, it is crucial for companies to develop a comprehensive corporate response plan that outlines the procedures for responding to a cyberattack. This response plan should be integrated into the broader ERM framework to ensure organizational readiness and resilience.

The risk management process should consider the varying levels of exposure to IFFs based on the type of real estate activities undertaken. Companies providing agency services or brokerage are more exposed to IFFs, while those involved in services such as project management and urban planning generally face lower risks. Therefore, risk assessments and subsequent policies should be tailored according to the level of exposure inherent to the company's operations. This differentiation ensures that the measures implemented are proportional to the actual risk each company faces, avoiding unnecessary administrative burdens for lower-risk activities.

Once the ERM programme has been established, it is important to maintain and improve it through continuous monitoring and enhancements as necessary. By systematically analysing the likelihood and impact of various risk factors, such as money laundering and other illicit activities, companies can identify potential threats and vulnerabilities. This includes mapping financial transactions, scrutinizing sources of funds and examining client backgrounds for suspicious activities. Utilizing frameworks such as the Financial Action Task Force (FATF) guidelines, firms can prioritize risks, develop strong anti-money laundering (AML) policies, conduct regular audits and ensure continuous adaptation to evolving legal requirements, thereby safeguarding their operations against illicit financial activities.

PRINCIPLE 3:
Development of policies, procedures and controls

While Principle 1 lays the foundation through governance and cultural efforts, Principle 3 specifies operational tools and procedures necessary to implement and enforce the anti-financial crime strategy.

Robust policies and procedures are the backbone of any effective anti-IFF strategy. This principle involves the creation and implementation of comprehensive policies and procedures addressing all aspects of anti-money laundering (AML) and anti-financial crime efforts. Key elements include customer due diligence (CDD) and know-your-customer (KYC) protocols, particularly for enhanced due diligence when dealing with politically exposed persons (PEPs). In the case of small-scale firms, where conducting CDD can be particularly challenging due to limited market power, restricted financial resources for hiring external services and difficulties in obtaining sufficient information from clients, firms are encouraged to adopt a simplified, risk-based approach to CDD. This approach should prioritize higher-risk clients or transactions while utilizing publicly available information to verify client backgrounds.

Policies, procedures and controls should be scalable based on the size and resources of the company. For small-scale firms, these measures should allow for a phased implementation that prioritizes high-impact actions in the initial stages, such as establishing basic integrity policies and performing essential due diligence. This approach ensures that small-scale firms can progressively develop more robust controls over time, without compromising their operational efficiency or competitiveness.

Maintaining transparent records of property ownership and transactions, along with accurate beneficial ownership information, is essential for audits and legal scrutiny. Procedures should encompass transaction monitoring, suspicious activity reporting, record-keeping and employee training. Regular reviews and updates ensure these policies remain effective and aligned with regulatory requirements and industry best practices.

Acquisitions and dispositions in real estate bring a number of third-party risks. While it is standard practice to conduct diligence on the assets (including regulatory licences and permits) that are being acquired, it is just as important to conduct diligence on the seller. If the seller was engaged in misconduct by, for example, purchasing the property with criminal proceeds or acquiring licences through corrupt means, there is a real risk that the purchaser could become involved in subsequent enforcement action, or the validity of the licences could be called into question. This is in addition to any potential money laundering matters that could arise.

Many businesses rely on real estate, including those that are new, such as data centres and renewable energy plants, or expanding, such as in technology and manufacturing. For example, companies setting up data centres require real estate that has all necessary regulatory licences and approvals. Again, conducting proper diligence on the seller is important, as is ensuring that the licences and permits have been obtained legitimately. Any misconduct may taint the asset and bring enforcement risks and reputational damage to the buyer.

PRINCIPLE 4:
Continuous assessment of the internal control environment

Continuous assessment of the internal control environment is critical for maintaining the effectiveness of anti-IFF measures in the real estate sector. Building on Principle 3, this involves regular reviews, evaluations and updates of compliance programmes, policies and procedures to identify any gaps or weaknesses. Collaboration with external agencies for insights and improvements ensures a comprehensive and proactive approach to maintaining robust internal controls. Both internal and external audits are essential to ensure the adequacy and effectiveness of these measures. Implementing robust monitoring systems that provide real-time alerts on suspicious activities enables timely intervention and helps ensure that anti-illicit financial flow strategies are consistently applied. Regular reviews of transaction patterns, customer profiles and compliance processes are necessary to detect any anomalies or emerging risks. This is particularly important in a depressed real estate market that may heighten certain risks of employee or third-party misconduct. For example, employees may make improper payments in order to secure a contract, obtain tax concessions or fast-track approvals in order to meet business or sales targets. Conducting regular reviews can help uncover this type of behaviour early so that it can be dealt with through employment action and enhancements to the company's processes and controls.

A comprehensive approach to continuous assessment includes monitoring of operations or centres of excellence and testing based on pre-planned schedules identified through annual or ongoing risk assessments. It is crucial to understand the difference between monitoring, which is continuous and integrated into daily operations, and testing, which is periodic and based on a predefined methodology. Documenting these activities ensures a thorough and transparent evaluation process. Continuous feedback and improvement mechanisms allow compliance programmes to evolve in response to changing regulatory requirements and emerging threats, maintaining the integrity and effectiveness of the firm's anti-IFF measures.

PRINCIPLE 5: Ongoing training and awareness raising

Training and awareness raising are fundamental to ensuring compliance and mitigating risks associated with illicit financial flows. Clear communication and training programmes ensure all employees understand and adhere to policies and procedures, fostering a culture of integrity. Training programmes should be risk-based, defined and continuous, stemming from comprehensive risk assessments. Enterprise-wide training should be conducted annually on all major risk exposures, with specialized training provided to groups exposed to higher risks, such as front-line staff (or brokers) who require additional instruction on documentation gathering and client obligations.

Training must be thoroughly documented, tracked and escalated if timing parameters are violated. Clear communication of the firm's values, policies and ethical expectations is crucial, and must be reinforced regularly through leadership actions, recognition programmes and employee engagement initiatives. Encouraging employees to report concerns or suspicious activities without fear of retaliation is essential for maintaining a transparent and compliant work environment, fostering a culture of integrity within the organization.

Training programs should be tailored not only by risk but also by the size and capacity of the organization. For small-scale firms, training should be designed to be concise and practical. The use of simple language and real-world examples will help ensure that all employees, regardless of their expertise, can comprehend and apply the training in their daily tasks.

PRINCIPLE 6: Effective change management

Effective change management is essential for maintaining the relevance and efficacy of anti-IFF measures amid evolving regulatory and compliance requirements. This principle entails proactively managing changes to regulations, industry practices and internal processes to ensure continuous compliance and risk mitigation.

A structured change management process includes regular monitoring of regulatory developments, industry trends and emerging risks. Firms should conduct impact assessments to evaluate the effects of changes on their compliance programmes and operations and develop action plans to address any identified gaps. Regular communication and training programmes, referred to in Principle 5, ensure all employees are aware of and prepared for regulatory changes. Knowing the regulatory inventory, including record keeping, retention and documentation requirements, is crucial. Clients should be assessed and scanned based on risk, with enhanced measures for higher-risk clients. Documenting Know Your Business (KYB) and Know Your Customer (KYC) processes as part of risk assessments ensures thorough compliance. Proactively managing change helps firms maintain effective anti-IFF measures and adhere to evolving legal standards.

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Endnotes

1 https://www.un.org/fr/desa/tax-abuse-money-laundering-and-corruption-plague-global-finance (United Nations Department of Economic and Social Affairs, s.d.)

2 https://initiatives.weforum.org/good-governance-community/paci-community (Partnering Against Corruption Initiative (PACI), World Economic Forum, s.d.)

3 https://initiatives.weforum.org/good-governance-community/paci-gatekeepers-workstream (Gatekeepers Advancing Integrity and Transparency (GAIT), World Economic Forum, s.d.)

4 https://www3.weforum.org/docs/WEF_Gatekeepers_A_Unifying_Framework_2021.pdf (Gatekeepers Unifying Framework, World Economic Forum, s.d.)