



# **The Application of the Risk Based Approach in the Real Estate Sector**

**Thematic Review 2023**

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## GLOSSARY

<b>AML/CFT</b>	<b>Anti-Money Laundering and Counter Funding of Terrorism</b>
<b>BO</b>	<b>Beneficial Owner</b>
<b>BRA</b>	<b>Business Risk Assessment</b>
<b>CRA</b>	<b>Customer Risk Assessment</b>
<b>CDD</b>	<b>Customer Due Diligence</b>
<b>EDD</b>	<b>Enhanced Due Diligence</b>
<b>FIAU</b>	<b>Financial Intelligence Analysis Unit</b>
<b>IPs</b>	<b>FIAU Implementing Procedures Part I</b>
<b>MLRO</b>	<b>Money Laundering Reporting Officer</b>
<b>ML/FT</b>	<b>Money Laundering and Funding of Terrorism</b>
<b>PMLFTR</b>	<b>Prevention of Money Laundering and Funding of Terrorism Regulations</b>
<b>PEP</b>	<b>Politically Exposed Person</b>
<b>SOW</b>	<b>Source of Wealth</b>
<b>SOF</b>	<b>Source of Funds</b>



# EXECUTIVE SUMMARY

During the second quarter of 2023, the FIAU’s Supervision section conducted a thematic review focusing on the real estate sector. The aim was to assess the application of the risk-based approach (RBA) by notaries and real estate agents when providing services relating to the buying and selling of immovable property in line with the obligations outlined in Regulation 7(8) of the PMLFTR. Specifically, the thematic review aimed to determine whether adequate measures are implemented by notaries and real estate agents to identify the money laundering and funding of terrorism (ML/FT) risks present in a property acquisition transaction. These measures are required to determine the appropriate proportionate CDD measures required to mitigate the ML/FT risks identified.

The results of the thematic review indicated that whilst, in general, notaries and real estate agents have a good understanding of the risk-based approach when carrying out CDD measures, there is scope for improvement in this context.

Since in the real estate sector the most significant ML/FT risks arise from the potential use of dirty money to buy property, improvements are recommended in relation to the collection of sufficient and relevant SOW/SOF documentation when the higher ML/FT risks identified merit the application of this measure.

On the other hand, in some instances, it was noted that excess measures were applied which were not proportionate to the lower ML/FT risk present in the transaction.

Therefore, improvements are recommended in ensuring that the CDD measures applied are commensurate vis-à-vis the ML/FT risks identified as part of the CRA carried out.

Notaries and real estate agents are encouraged to consult the relevant sections of this document for a deeper understanding of the findings identified through the thematic review and recommendations for improvement.





# SCOPE OF THE THEMATIC REVIEW



The role of notaries and real estate agents is pivotal in preventing the misuse of the real estate sector for ML/FT purposes, through their implementation of robust AML/CFT control frameworks in accordance with the PMLFTR, the IPs Part I, as well as other guidance issued by the FIAU in this context.

As real estate transactions enable the transfer of significant funds in a single and large transaction, criminals may exploit this inherent vulnerability by purchasing immovable property to launder illicit proceeds. This implies that notaries and real estate agents are exposed to the risk of money laundering due to immovable property acquisitions being an attractive method for criminals to conceal their illicit proceeds. This vulnerability is heightened if notaries and real estate agents who facilitate the transfer of immovable property between different parties have a poor level of understanding of the relevant ML/FT risks and of their obligations and procedures.

**In view of this, the FIAU conducted a thematic review in 2023 to assess the understanding and implementation by notaries and real estate agents of the risk-based approach when carrying out occasional transactions .**

Specifically, the thematic review was undertaken to assess compliance by notaries and real estate agents with the obligations emanating from Regulation 7(8) of the PMLFTR, when providing services relating to the buying and selling of immovable property, including:

1. The assessment of written policies and procedures that define the extent of CDD measures to be applied, contingent upon the level of ML/FT risk determined through the CRA.
2. An assessment of the effectiveness of the CRA to adequately identify the ML/FT risks for each occasional transaction executed, thereby guiding the determination of the appropriate CDD measures to be applied.
3. An assessment of whether additional identification and verification measures are undertaken depending on the ML/FT risks identified through the CRA.
4. An assessment of SOW/SOF measures applied, including whether supporting documentation is obtained to substantiate the information collected on SOW/SOF, depending on the risks identified.
5. An assessment of the PEP measures applied to mitigate any heightened risk posed by their involvement in the transaction.

# THEMATIC REVIEW METHODOLOGY

The thematic review consisted of compliance examinations of 20 subject persons, comprising of 15 notaries and 5 real estate agents. Of the 5 real estate agents examined, 3 were operating as firms whilst the remaining were operating as sole practitioners. The customer file testing in relation to the compliance examinations was limited to occasional transactions that involved the transfer of immovable property through a deed of sale carried out between 1st April 2021 and 31st March 2023.

Taking one full calendar year into consideration, the 15 notaries examined had, in aggregate, executed 1,027 deeds of sale in 2022, whilst the 5 real estate agents were involved in 227 deeds of sale in 2022. On average, the examined subject persons were involved in circa 60 deeds of sale each.

Chart 1  
2022 Property Transactions by the Examined Notaries

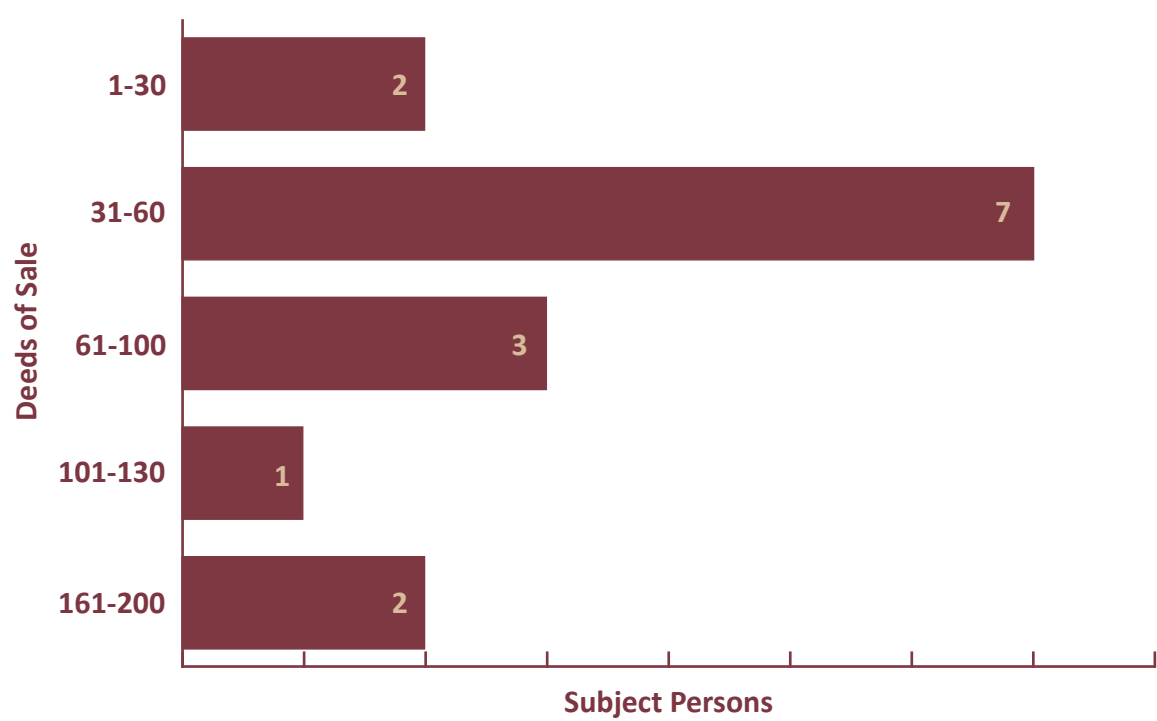
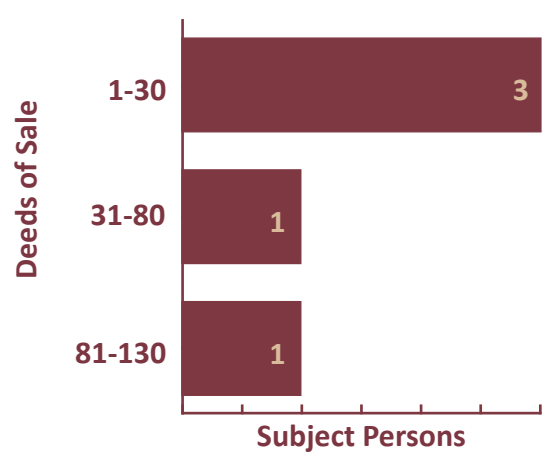


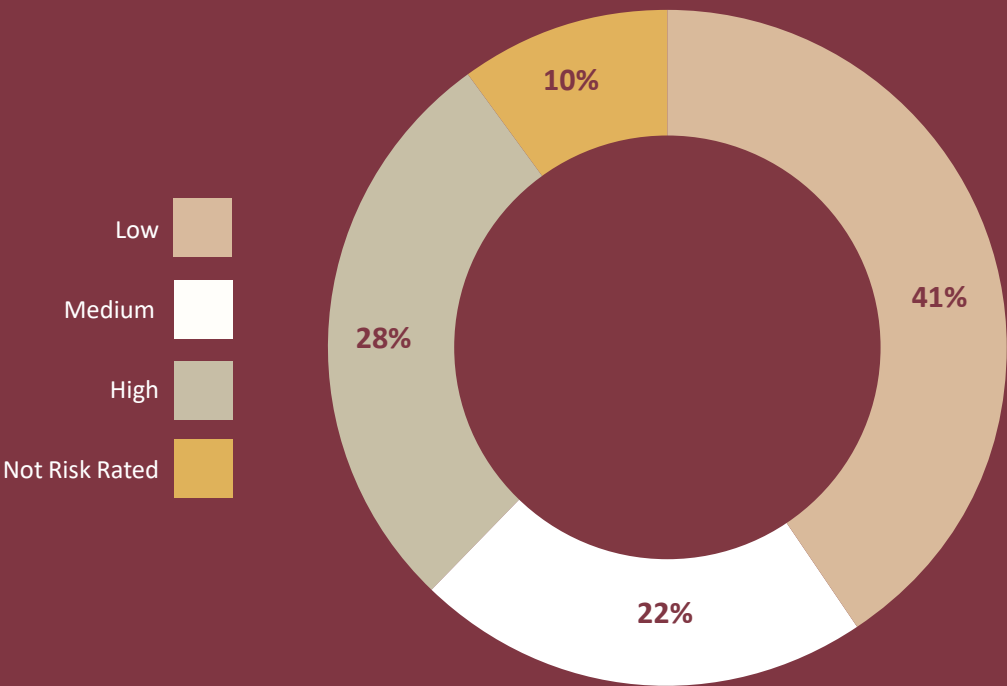
Chart 2  
2022 Property Transactions by the Examined Real Estate Agents



The assessors selected occasional transactions posing different levels of risk for the purpose of assessing whether the CDD measures applied by notaries and real estate agents were commensurate and targeted with the level and type of risk identified.

Additionally, since in the real estate sector the most significant ML/FT risks arise from the potential use of dirty money to buy property, the FIAU selected occasional transactions which varied in financing methods, that is, financed through own funds, third party funds and bank loans.

**Chart 3**  
**Risk Rating of Examined Occasional Transactions**



**Phase 1: Controls Design Testing**

The notaries and real estate agents were examined on the adequacy of the design of their controls, policies, and procedures in place to address their obligations under Regulations 7(8) and 11(1)(b) of the PMLFTR and Sections 3.6 and 4.4.3 of the IPs. This was done by reviewing the examined subject persons’ written policies and procedures. This phase also included an interview with the MLRO or other key officials to obtain a better understanding of the application of the risk-based approach.

**Phase 2: Controls Implementation Testing**

During this phase, the FIAU evaluated the subject persons’ effective implementation of controls to comply with the obligations under review. A sample of six deeds of sale conducted by each notary or real estate agent were chosen by the assessors. The subject persons were required to provide information and, where applicable, documentation for each deed of sale selected. This was required to demonstrate how the risk-based approach was applied, which information and documentation was subsequently reviewed by the assessors.



# KEY FINDINGS FROM THE THEMATIC REVIEW

## OVERALL ANALYSIS

The information and documentation provided by the 20 examined subject persons, in the context of assessing the application of the risk-based approach, were aggregated by the assessors to formulate an overall analysis. The results of this analysis are shown below.

Chart 4  
Risk Based Approach Application Effectiveness





## POLICIES AND PROCEDURES

### Regulatory Obligation and FIAU Guidance

Regulation 5(5)(a) of the PMLFTR and Section 3.4 of the IPs require subject persons to have in place and implement measures, policies, and controls which address the risks identified in the risk assessment conducted in accordance with Regulation 5(1) of the PMLFTR. Section 3.4 of the IPs also requires that the measures, policies, controls, and procedures be clearly documented and, where applicable, approved by senior management.

Regulation 7(8) of the PMLFTR requires the extent of CDD measures to be commensurate to the risk of ML/FT identified through the risk assessment and may vary from case to case. Therefore, the level and type of CDD measures to be applied on a particular customer depends on the level and type of risk that customer poses.

### Findings



All examined subject persons had written policies and procedures in place. However, at times, these documents were too generic and did not clearly explain the measures, policies, controls, and procedures to be implemented to address the risks identified in the BRA.



A number of subject persons who engaged consultants to assist in the drafting of the policies and procedures and to whom they are outsourcing the implementation of CDD measures, experienced difficulties in explaining to the assessors such policies and procedures.



### Key Takeaways

1. The risk-based approach to the application of CDD measures should be clearly documented and reflect the nature and size of the subject person’s business activities. It should not consist of solely quoting obligations emanating from the PMLFTR and/ or the IPs. Specifically, there needs to be a better definition of the scenarios which would result in an occasional transaction being assessed as posing a higher ML/ FT risk. This would then require taking enhanced due diligence measures, such as by obtaining information and, where applicable, supporting documentation on the purchaser’s SOW/SOF.
2. Although, as per Chapter 6 of the IPs, subject persons may engage consultants to assist in the drawing up of policies and procedures, subject persons are ultimately responsible for compliance with AML/CFT obligations. Therefore, it is imperative that subject persons are knowledgeable and fully understand their policies and procedures and ensure that these address the ML/FT risks to which it is exposed.

# CUSTOMER RISK ASSESSMENT

## Regulatory Obligation and FIAU Guidance

Regulation 5(5)(a) of the PMLFTR requires subject persons to have in place CRA procedures. Section 3.5 of the IPs further elaborates that subject persons need to understand the risk inherent in a particular occasional transaction by conducting a CRA. The information gathered by it will formulate the customer’s risk profile, which will determine the proper level of CDD measures to be applied. Subject persons are to ensure that the complexity of the CRA reflects the nature of the relationship/transaction. Its outcome must be objective, reasonably justified and documented by the subject person.

## Findings

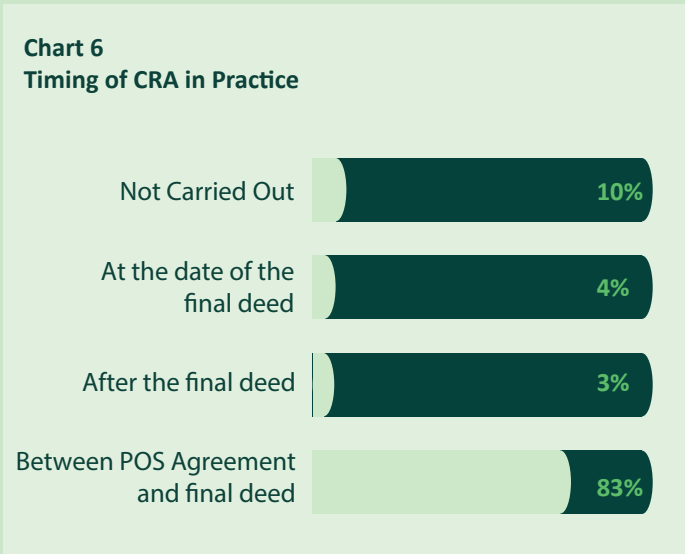
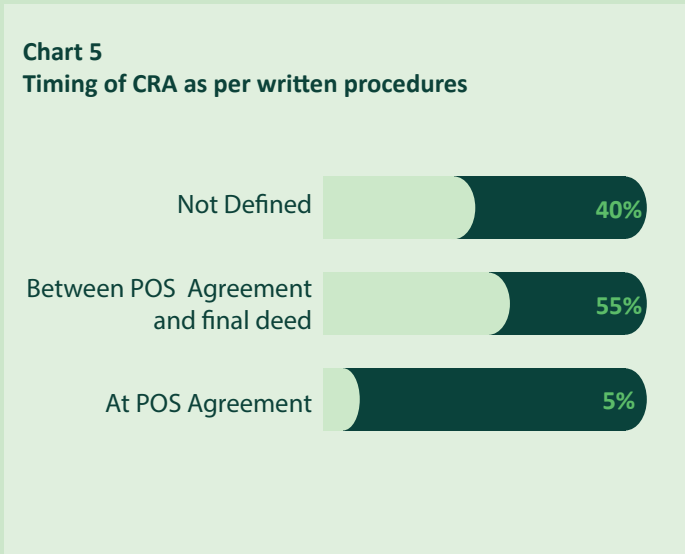


### Timing of the CRA

It was of note that most notaries and real estate agents had in place risk assessment procedures. However, 40% of the procedures reviewed failed to determine at which stage the notary or real estate agent should carry out the CRA. Whereas, in 55% of the procedures reviewed it was stated that the CRA should be carried out between the promise of sale agreement and the final deed of sale.

In practice, in 83% of the cases, the CRA was performed between the promise of sale agreement and the final deed of sale, as stipulated in the written procedures. However, in circa 14% of the occasional transactions tested, the subject persons concerned either did not conduct a CRA or the CRA was conducted after the deed of sale was concluded. A minority of subject persons carried out the CRA at final deed stage.

As a result of not carrying out the CRA or carrying it out late, the risk factors pertaining to the respective occasional transaction were not identified and assessed or identified and assessed late, and consequently, a risk-based approach in the implementation of the control measures to mitigate the risk could not be adopted.





The CRAs for the occasional transactions reviewed, revealed five main ML/FT risks as identified by the examined notaries and real estate agents:



Higher risk factors in the CRA

Funding method:

Individuals may invest personal or third-party funds acquired illicitly in immovable property for the purpose of legitimising the proceeds.

Property value and location:

A further risk emerges from the opportunity of legitimising a substantial sum of money in a single large transaction. The location of the property may pose further risk in the case of special designated areas (SDAs) which are by default considered to be higher valued properties.

PEP involvement:

PEPs may acquire properties as means to launder funds acquired through acts of bribery or corruption.

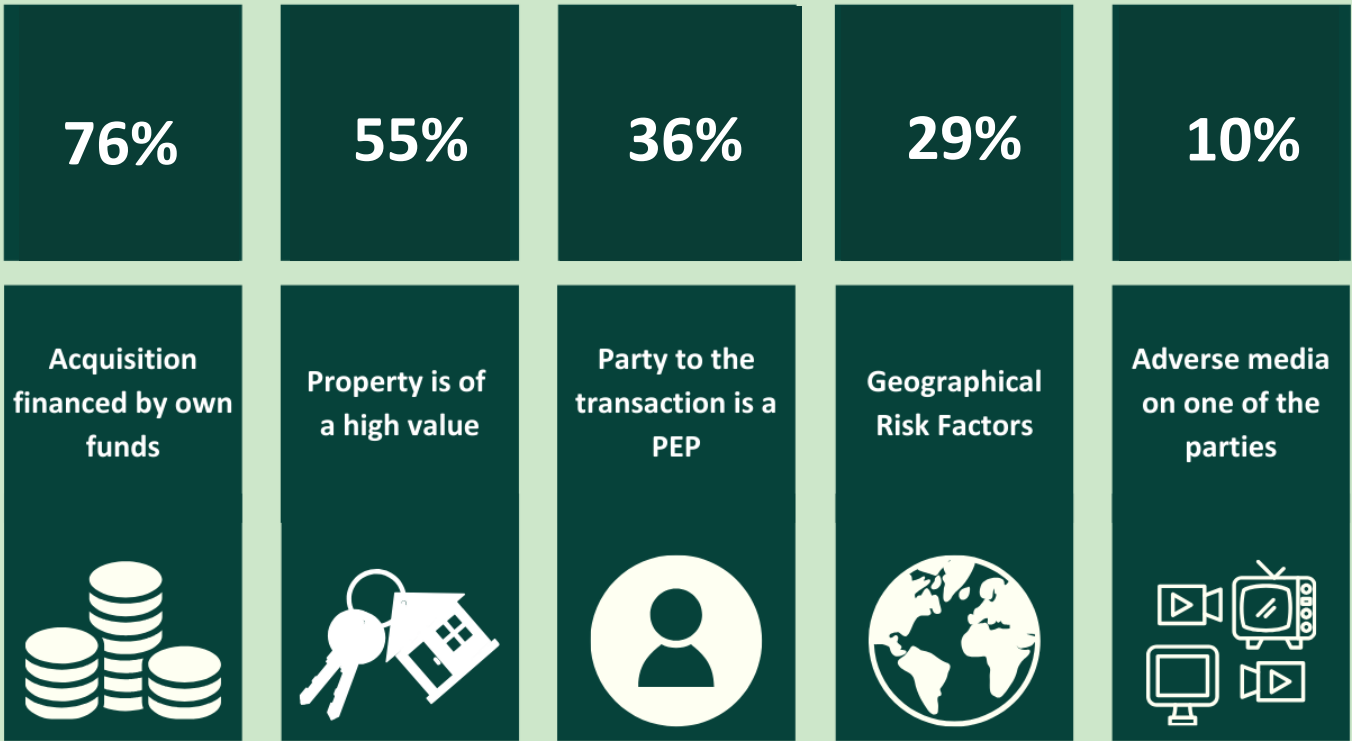
Geographical risk factors:

A purchaser residing in or connected to a high-risk jurisdiction increases the risk. In this case funds used to acquire the immovable property may be sourced from jurisdictions with poor AML/CFT control frameworks in place. This leads to the risk of the source of funds being derived from illicit activities.

Adverse media on the involved parties:

Material adverse information linking the parties involved in an occasional transaction to crime heightens the risk (e.g. a purchaser recently accused of tax evasion increases the risk that funds to be used to finance the property acquisition were obtained from illicit activities).

Common risk factors that heightened the overall risk rating assigned to an occasional transaction





Checks conducted on the CRA for each sampled occasional transaction revealed that, when taking into consideration the risk factors present in each transaction, 82% of the CRAs had an appropriate risk rating assigned. However, 18% of CRAs were found to be assigned an inappropriate risk rating. In the latter scenario, this was mainly due to a lower risk rating being assigned notwithstanding the fact that higher risk factors were present in the occasional transactions. It is noteworthy that a significant number of property transactions funded through personal funds did not receive a higher risk rating which they merited. An inappropriate risk understanding and, ultimately, rating, hinders the implementation of control measures on a risk-based approach.

**Chart 7**  
**Timing of CRA as per written procedures**



The case studies below provide examples of an inadequate risk rating assigned to occasional transactions reviewed:

Case Study 1: Donation from PEP	Case Study 2: Own Funds
<p>A natural person in his early thirties requested the services of a notary to purchase a property for the value of €720,000. The property was financed through own funds derived from employment and from a substantial donation from his parents. The purchaser’s father met the definition of a PEP as he was a judge. Since a medium risk rating was assigned to the transaction, the subject person concerned did not carry out enhance due diligence. The substantial donation from a PEP to acquire the property increased the ML/FT risk. Therefore, EDD measures were required to mitigate such risks and to ascertain that funds donated did not result from illicit proceeds.</p>	<p>A property being sold at a value of €1,150,000 was fully paid from own funds by a sole individual purchaser on whom adverse media was identified in relation to fraud. A medium risk rating was assigned to the transaction and only basic checks were carried out by the subject person on the funds used to finance the property acquisition. However, in such a scenario the funding method and the adverse media hits increased the ML/FT risk and therefore a higher risk rating should have been assigned, which warranted the application of EDD.</p>
Case Study 3: Funding Method	
<p>Two natural persons bought a property for €3,000,000 out of their own funds, which included a private loan from their own company. While the transaction was assigned a medium risk, the funding method, and the value of the property warranted the assignment of a higher risk, as well as the application of EDD measures.</p>	





## Key Takeaways

1. In the absence of a CRA, subject persons face great challenges in implementing an effective risk-based approach, as the risk factors remain undefined and unassessed. It is imperative that subject persons integrate CRA procedures in their AML/CFT control framework, since it directs the application of appropriate control measures tailored to each customer's risk profile.
2. The objective of the CRA is to ensure whether an occasional transaction presents an elevated ML/FT risk and which risk factors have contributed to the heightened risk (e.g. the risk is heightened due to the funding method used by the purchaser). The outcome of this assessment must be evaluated to determine the extent and type of mitigating measures to be applied. Consequently, the CRA should be conducted in a timely manner and should precede the execution of the occasional transaction.
3. It is not necessary to implement an overly complex CRA methodology, if risk factors are well assessed, with specific attention given to those that may elevate the risk level and which would therefore necessitate the implementation of corresponding mitigating measures.
4. Whilst subject persons may engage consultants with developing a CRA methodology, it is important that subject persons understand the methodology adopted and the typical ML/FT risks which can be present in a real estate transaction. Ultimately, notaries and real estate agents are the ones meeting the customers. Therefore, they must be knowledgeable of the appropriate information they should request from customers to better understand the risk exposure. Furthermore, they must look out for any red flags during discussions held with their customers. In this regard, notaries and real estate agents are encouraged to consult and familiarise themselves with the FIAU's "Guidance Paper for the Property Sector: Risk Factors, Mitigating Measures, Red Flags and Case Studies."

# IDENTIFICATION AND VERIFICATION OF CUSTOMERS

## Regulatory Obligation and FIAU Guidance

Regulation 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3 of the IPs Part I oblige subject persons to identify the customers and, where applicable, their BOs, and verify their identity. This is done by utilising documents, data, or information obtained from a reliable and independent source. In the case of a customer being a legal entity, subject persons are further required to validate the legal status of the entity and identify all directors (or individuals entrusted with its administration and representation).

Section 4.3 of the IPs Part I provides an in-depth explanation of the specific information to be collected to identify the customer, and outlines the documentation required for the identity verification process. While the personal identification details, as referred to in Section 4.3.1 (i) of the IPs Part I, have to be verified in all cases, the extent of the identification and verification measures applied is to be commensurate to the level of risk identified and the assessed risk factors.

## Findings



In general, the vast majority of the examined notaries and real estate agents conducted identification and identity verification procedures on all the vendors, purchasers, and, when relevant, agents (that is, persons that would be appearing on behalf of a party via a power of attorney during the promise of sale agreement and/or the final deed of sale), by obtaining the appropriate documentation as specified in the IPs. However, two of the subject persons examined, namely one notary and one real estate agent, were unaware of the obligation to verify the identity of the vendor/s in the transaction.



25% of the written procedures pertaining to the examined subject persons did not include provisions on the requirement to implement additional identity verification measures for occasional transactions with higher risk elements concerning the customer’s identity. Nevertheless, in practice, 95% of examined subject persons had implemented additional identity verification measures for customers as required in view of the higher risk elements in the transaction, such as non-face-to-face interactions.



It was noted that in 16% of occasional transactions reviewed, subject persons applied additional identification and verification measures although these measures were considered unnecessary, since they did not serve to mitigate any specific risk factor/s identified in the transaction. For instance, obtaining additional identity verification documents (e.g. requesting a copy of the customer’s passport beyond the identity card already obtained) would not offer much additional value when there are no concerns in respect of the customer’s identity.



**Out of 19 occasional transactions reviewed that required additional identification and verification measures (due to the higher risks present in the occasional transaction), only one occasional transaction lacked these additional measures.**





Based on the examined occasional transactions, the following are more examples of unnecessary identify verification measures taken. It is important to note that while in other situations these measures might be appropriate (e.g. the purchaser was not present during the signing of the deed of sale since s/he was represented by a mandatory), these measures were considered unnecessary due to the fact that they were unrelated to the risk posed by the specific occasional transaction.



Identity cards were certified and apostilled when not required



Identity verification documents were collected on shareholders holding minimal shares in the vendor company (and therefore not meeting the definition of beneficial owner)



## Key Takeaways

1. In accordance with the abovementioned FIAU's Guidance Paper for the Property Sector, notaries and real estate agents are reminded that they are acting for both parties to the transaction. Therefore, the term 'customer' must be interpreted to include both the purchaser and the vendor. Consequently, identification and verification procedures must be implemented on both parties involved in the transaction and should not be limited to the purchaser.
2. Implementing the risk based approach necessitates subject persons to also determine whether additional measures should be applied to identify and verify the identity of customers. Therefore, if no identification-related risks are identified, subject persons should reconsider carrying out additional identification and verification measures as it may not add any value in mitigating the identified risks present in the occasional transaction.
3. On the other hand, where identification-related risks are identified, subject persons may apply a number of mitigating measures as set out in Section 4.3.1.2 of the IPs. For example, if the customer is met on a non-face-to-face basis, the subject person may either require additional identification documents or may opt to hold a video conference with the customer to visually verify their face against the respective identity verification documents collected. In the case where documentation collected shows different residential addresses pertaining to the same customer, subject persons may query this with the customer and obtain additional documents, such as, a recent utility bill or correspondence from a governmental authority, among others.

# SOURCE OF WEALTH AND SOURCE OF FUNDS

## Regulatory Obligation and FIAU Guidance

Section 4.4.3 of IPs Part I, outline that while there is no express obligation to establish the customer’s SOW/SOF when carrying out occasional transactions, subject persons should still bear in mind that certain occasional transactions may present an ML/FT risk that can only be mitigated through obtaining information on the customer’s SOW and SOF. When the ML/FT risk within an occasional transaction is assessed to be high, and therefore, EDD is required, it is very likely that the most effective measure that can be taken is to query how the funds being used were acquired and whether this makes sense, considering the customers SOW. Thus, subject persons should not refrain from asking about the customers SOW and SOF if this information serves to mitigate the risk of the transaction. On the other hand, as indicated in the FIAU’s Guidance Paper for the Property Sector, it should not be standard procedure to request the SOW/SOF of the vendor, unless it mitigates a particular ML/FT risk identified.

## Findings

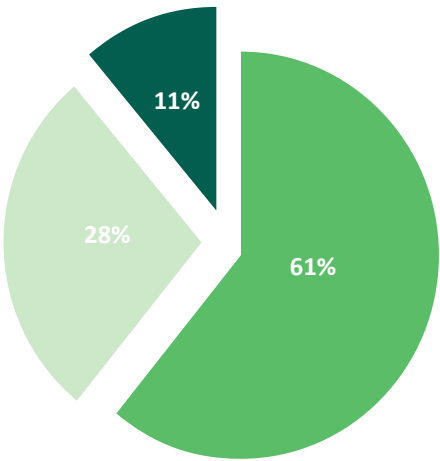


All subject persons had written procedures for gathering SOW/SOF information in relation to the purchasers. Furthermore, except for two subject persons, all written procedures included the requirement to collect supporting documentation contingent upon the associated risk. In some instances, the written procedures also included examples as to the type of supporting documentation which may be obtained depending on the source of funding.



In most occasional transactions examined, SOW/SOF documentation on the purchaser was adequately collected in accordance with the requirements highlighted in the PMLFTR and the IPs. However, it is noteworthy that in **28%** of the occasional transactions the collected documentation was considered unnecessary, because it did not target nor mitigate any identified risk.<sup>1</sup> In a smaller percentage (**11%**) of occasional transactions, the collected documentation was considered insufficient to mitigate the risk posed, therefore leaving the subject person exposed to ML/FT risk without applying appropriate comprehensive mitigating measures.

Chart 8  
Collection of SOW/SOF Documentation



<sup>1</sup> Reference is made to the case study number eight below for a typical scenario which does not necessitate the collection of SOW/SOF verification documents.



SOW/SOF of purchasers



In all the occasional transactions reviewed subject persons obtained basic information relating to the SOW/SOF of purchasers.



In the occasional transactions where the information and/or documentation with respect to the purchaser’s SOW/SOF was not deemed sufficient, this was due to several reasons, such as:

- a. Information obtained was vague (such as listing SOWSOF as ‘self-employed’ without indicating the industry/sector).
- b. The bank statements only showed that the purchaser had available the necessary funds to finance the property acquisition, but no further information/documentation was obtained on how the funds were obtained.
- c. There was lack of information on the business of the company which the purchaser claimed would fund the property acquisition (such as no information on whether the company is financially able to finance the transaction).
- d. No SOF documentation obtained in relation to third parties who provided the funds for the transaction.

SOW/SOF of Vendors



Only a handful of subject persons had written procedures outlining the limited instances where SOW/SOF information/documentation on the vendors would be required. Despite this, the majority of subject persons demonstrated good understanding of the risk-based approach, since they acknowledged that obtaining information and/or documentation on the vendors’ SOW/SOF would generally not serve to mitigate the identified ML/FT risk of the transaction.

## Case Studies

### Information/documentation on the purchaser's SOW/SOF was insufficient

#### Case-study 4

The purchaser, a non-EU national who recently relocated to Malta, financed the entire transaction, amounting to approximately €300,000, through own funds originating from employment in his country. While the subject person had requested information on the purchaser's SOW/SOF through the onboarding form, the information requested and obtained was too generic, as it solely indicated the purchaser's occupation. The subject person did not query further, including, for example, about his place of employment, his annual income, nor did the subject person collect any supporting documentation in respect of the purchaser's SOW/SOF.

Further information and documentation were required due to the heightened risk posed by financing through own funds.

#### Case-study 5

A property acquisition for the value of €325,000 by a Maltese company ('buying company') was largely funded through a loan from a non-Maltese company ('lending company'), as detailed in a loan declaration between the companies, whereby the lending company loaned €307,755 to the buying company. This was not a formal loan agreement, but rather a short declaration by the lending company declaring the granting of the loan. The lending company's main activities did not involve the provision of lending facilities to third parties. Despite collecting some SOF documentation about the buying company in the form of financial statements, the relationship between the buying company and the lending company was not understood by the subject person. Due to this, there was a lack of understanding around the funds being loaned. This was especially important since the buying company did not appear to have any connection with the jurisdiction in which the lending company was registered or with the sector in which the lending company was operating.

The source and reasoning behind the funds must be fully understood to ensure that any or all ML/FT risks are mitigated. If the subject person is not satisfied with the explanation as to the legitimate SOF, they should consider filing a suspicious transaction report with the FIAU.

#### Case Study 6

The purchaser, a Maltese national in his twenties, bought a property valued at €545,000 out of own funds. The SOW/SOF documentation collected only covered the value of €385,000 which the purchaser obtained from the sale of another property. This implied that a total of €160,000 was unaccounted for, with a note recorded by the subject person 'funds from savings', with no documentation to validate the statement. This was considered a concern as it did not fit with the purchaser's profile since he earned less than €25,000 per year.

Any inconsistencies with the customer's profile must be followed-up to ensure the legitimacy of the funds utilised.

#### Case Study 7

A property valued at €321,500 was bought by a non-EU national individual solely through own funds acquired through his employment. A bank statement was obtained by the subject person showing that the funds were indeed available in his bank account. However, the statement only indicated a balance equivalent to the property value, but no additional information was obtained to understand how the funds were obtained. Moreover, the occupation of the purchaser could not be proven through open-source searches, as the name of the employing company and the purchaser's name did not produce any results.

Subject persons are to ensure that the SOW/SOF is fully understood and verified. Further documentation should have been collected such as a signed employment contract or payslips to prove employment as the SOW/SOF.

**SOW/SOF supporting documentation on the purchaser collected although not necessary to mitigate ML/FT risk**

**Case Study 8**

The transaction was risk-rated as low since 80% of the funds to finance the acquisition were derived through a bank loan from a Maltese credit institution. The purchasers were a Maltese couple who were interacting with the notary on a face-to-face basis. The remaining funds consisted of own funds accumulated through both purchasers’ employment as accountants.

The transaction was valued at €255,000, thereby resulting in a total of €51,000 being sourced from own funds. Due to the type of employment of both purchasers and the length of their employment, the accumulation of this amount is within reason and poses no ML/FT risk. Notwithstanding this, the subject person collected supporting documentation to verify the employment of the purchasers, their annual income, and copies of their bank statements.

**SOW/SOF documentation obtained on the vendor although not necessary to mitigate ML/FT risk**

**Case Study 9**

Due to the high value of the property being sold, a higher risk-rating was assigned to the transaction. Based on this risk rating, the SP collected several documents related to the employment of the vendor, despite no specific ML/FT risk being posed by the vendor. Such documentation did not mitigate the risk of the transaction, that is, that the funds used by the purchaser to finance the high value property acquisition may have been obtained from illicit sources. Therefore, the correct risk-based approach in this case would require obtaining SOW/SOF documentation on the purchaser, who was funding the high value property, rather than on the vendor.







## Key Takeaways

1. The first step to implement an effective risk-based approach is establishing written procedures that enable subject persons to manage and mitigate ML/FT risks identified. This includes setting out the different property acquisition funding methods which would dictate what SOW/SOF information would be required, whether any supporting documentation in relation to this is necessary, and if so, the type of SOW/SOF verification documentation to be obtained.
2. The collection of SOW/SOF documentation may not be necessary for every property acquisition transaction. This should be requested if pertinent ML/FT risks in the funding methods are identified as demonstrated in the case-studies in this section.
3. The type of SOW/SOF documentation collected should always be sufficient to substantiate the information obtained and in response to and to target a particular risk posed. Examples of SOW/SOF documentation that may be collected include, but is not limited to, the following:
  - a. Payslips and FS3 showing salary payments when property acquisition is funded through employment income.
  - b. Financial statements to show the liquidity and profitability of a company funding the transaction.
  - c. Deed of sale or bank transfer showing the proceeds from the sale when the real estate purchase is funded through another property sale.
  - d. Deed of donation, private writing, or other proof of donation (such as bank transfer statements) when funding is through a donation, including documentation on the SOW/SOF of the donor where necessary, taking into consideration the amount of donation.
  - e. The will or the causa mortis declaration, if funded through an inheritance.
4. Within the real estate sector, the most significant ML/FT risks arise from the potential use of dirty money to buy a property. Since it is the purchaser who utilises funds to acquire property, most of the time they will pose the higher risk of money laundering. Therefore, the collection of SOW/SOF information/documentation should be focused on the purchaser, unless specific risks or red flags associated with the vendor emerge.

# POLITICALLY EXPOSED PERSONS

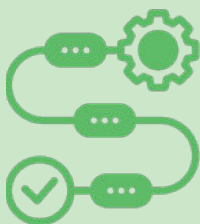
## Regulatory Obligation and FIAU Guidance

In line with Regulation 11(5) of the PMLFTR, subject person’s risk management procedures are to include measures to determine whether a customer or BO is a PEP and apply EDD measures in relation to them, their family members and persons known to be close associates. Whereas both the purchaser and the vendor must be checked for their PEP status, as explained in the FIAU’s Guidance Paper for the Property Sector, the risk of ML/FT is more significant when the purchaser is a PEP.

Section 4.9.2.2 of Part I of the IPs clarifies that not every PEP poses the same risk of ML/FT, therefore, subject persons are to assess the risk they are exposed to and determine, based on the CRA, the level of EDD measures required. The FIAU’s Guidance Paper for the Property Sector guides subject persons to take steps to ensure that the funds utilised for the transaction are legitimate by establishing the purchaser’s SOW/SOF and obtaining relevant substantiating documents. In instances where the vendor is a PEP, subject persons should assess whether there are any unusual circumstances surrounding the sale.

Persons to be considered as PEPs can be found on the Prominent public functions at national level, at the level of International Organisations and at the level of the European Union Institutions and Bodies on the Official Journal of the European Union. This list provides all the public functions for which each EU Member state considers the person entrusted with that function as a PEP.

## Findings

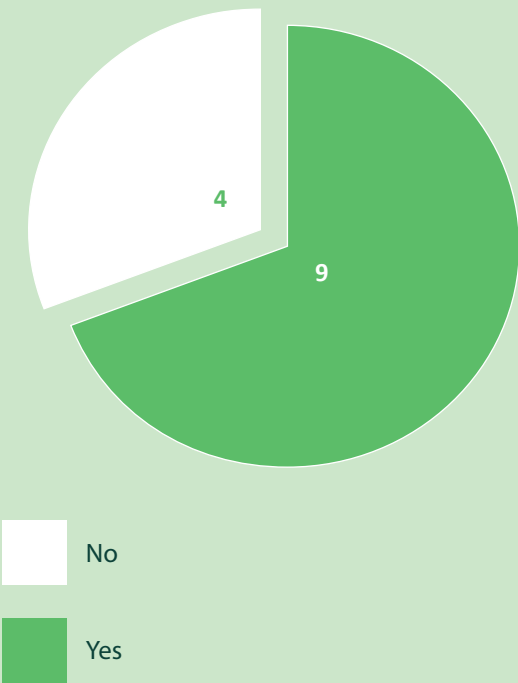


80% of subject persons had written procedures in place to determine whether customers and/or their BOs are PEPs. However, only 60% of subject persons had written procedures in place to apply specific measures in relation to PEPs to mitigate the risk arising from their involvement in the transaction.



PEPs were involved as vendors or purchasers in 17 out of the 120 occasional transactions examined. Generally, the subject persons examined applied satisfactory measures to mitigate the ML/FT risk arising out of the PEP involvement in the transaction. In four (23.5%) of the cases where a PEP was party to a transaction and measures were applied, these measures were not deemed adequate.

Chart 9  
Were the Measures Effective to mitigate the ML/FT risk?



## Examples of inadequate application of PEP related measures

1

Even though a person may have resigned from a position listed as a PEP, for the purposes of AML/CFT obligations they remain a PEP up to a year later. The subject person was not aware of this fact and therefore did not apply EDD measures.

2

The subject person noted a purchaser was not a PEP. However, independent checks carried out by the assessor, revealed that was in fact a PEP. This indicated that the subject person had inadequate measures to determine whether a customer or a BO was a PEP. As a result, no EDD measure were applied by the subject person.

3

The SOW/SOF documentation collected on the PEP purchasing the property failed to support the portion of own funds used for the sale, and the subject person did not request more documentation. Consequently, the documentation was not enough to mitigate the PEP ML/FT risk.



### Key Takeaways

1. The risk-based approach requires subject persons to fully understand the risk posed by a PEP in an occasional transaction. They must consider the type of PEP, their nationality, and other circumstances of the specific occasional transaction to ensure that adequate measures are applied to mitigate the associated risk.
2. Verifying the SOW/SOF utilised in the purchase of immovable property by the PEP by obtaining supporting documentation is necessary to ensure that the funds utilised derive from a legitimate source and are in line with the PEP’s salary and declared earnings. With respect to the PEP vendor, the subject person is to assess the occasional transaction and consider whether there is anything unusual that would warrant further checks.
3. In accordance with the PMLFTR and the IPs, PEPs are to remain considered as such for 12 months after the termination of the role. Therefore, appropriate EDD measures are still to be applied during this period.
4. Subject persons are reminded of the importance of proper checks and screening to ensure that any PEP involvement is detected, allowing for the proper implementation of measures to combat the increased ML/FT risks caused by PEP/s.



# CONCLUSION

An effective AML/CFT regime is strongly dependent on a good understanding of the risk-based approach. This enables a proper identification of the ML/FT risks and the application of targeted and proportionate measures to manage these identified risks. It is therefore critical for notaries and real estate agents to be regularly trained. Knowledge about ML/FT risks and typologies in the real estate sector, how to recognise red flags present in an occasional transaction and what commensurate CDD measures to apply to mitigate the ML/FT risks identified is crucial. In addition, subject persons must keep up to date with guidance issued by the FIAU, national and supra-national risk assessments conducted, and guidance issued by other international bodies such as the Financial Action Task Force (FATF)<sup>2</sup>. A sector with knowledgeable gatekeepers is less prone to abuse by criminals attempting to launder their criminal profits.

Whilst this thematic review yielded positive results on the property sector’s compliance with the risk-based approach, the FIAU has also concluded that there is room for improvement. To this end, the FIAU encourages all notaries and real estate agents involved in the buying and selling of immovable property to review their procedures in this area and assess whether any of the above-mentioned findings are present in their practice. It so, they are to take active steps to implement measures to address the recommended areas for improvement.



**The FIAU encourages all notaries and real estate agents involved in the buying and selling of immovable property to review their procedures in this area and assess whether any of the above-mentioned findings are present in their practice.**

<sup>2</sup> Reference is made to the 2022 FATF publication entitled “Risk-based Approach Guidance for the Real Estate Sector”.



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