

FINANCIAL SERVICES

Convergence of luxury and anti-money laundering

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David Friedman. Photo: Michael Falco

By **David Friedman**

It was the 2015 launch of the Knight Frank/Douglas Elliman Wealth Report on the 64th floor of the World Trade Center.

On stage beside me was Patrick Gallagher, vice president of NetJets, along with Howard Lorber who was at the time chairman of Douglas Elliman, with the panel being moderated by Robert Frank, the current wealth reporter for CNBC.

As the panel progressed and at one point, I looked out over the audience of hundreds of agents in attendance and made what at that time seemed like a cryptic prediction: "Anti-money laundering (AML) and know-your-customer (KYC) compliance are coming to luxury and specifically to luxury real estate."

With Russia's invasion of Ukraine, this geopolitical crisis has brought into sharp focus the intersection of geopolitics, Russian oligarchs, luxury and compliance risks.

As President Biden put it in his state of the Union address:

"We are joining with our European allies to find and seize your yachts, your luxury apartments, your private jets. We are coming for your ill-begotten gains."

The press is ablaze with accounts about Russian oligarchs' wealth with seizures captures the headlines.

Outflow of Russian oligarch wealth had been building over the past decade. Also interesting was Knight Frank head of research Liam Bailey's presentation on data from the company's research that highlighted 33 percent of Russia's ultra-wealthy were at the time considering moving out of the country.

Against that backdrop and combined with the *New York* magazine's front cover entitled, "New York Real Estate: The New Swiss Bank Account," the writing was on the wall for what we see unfolding for the geo-political implications of luxury swirling around the Russian invasion of Ukraine.

Department of Justice releases regulations around disclosure by foreign ownership of real estate. A couple of months later I received a text from Robert Frank saying, "You nailed it!" He was referring to the story in *The Wall Street Journal* reporting the launch of an investigatory unit by the Department of Justice using FBI agents focused on combing through public data records of real estate ownership to find foreign entity ownership that failed to disclose the principal owners.

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Most wealthy families or individuals attempt to obscure ownership of real estate assets by using opaque LLC or LLP structures.

The new regulations passed by the Department of Justice mandated transparency of any foreign owner of luxury real estate above \$3 million in New York and above \$1 million in Miami, for example.

Those steps laid the groundwork and foundation for the much of what we are witnessing today in terms of the implication of Russian oligarch wealth residing in real estate assets in the United States.

Risk and scrutiny overflow into real estate investments. Simultaneously, I was speaking at a family office seminar on the West Coast hosted by U.S. Trust where I was raising the coming convergence between the global risk and wealth Graphs.

After my presentation, a family office approached me to say thank you for trying to help the advisors better understand these issues around risk and luxury. They revealed that there was a building in Manhattan in which they had done due diligence around purchasing the embedded hotel. They confessed that in the end they backed away from the acquisition because of an individual who lived in the building of Russian nationality and the potential security that the building would draw from the Department of Justice.

Overlap between the global wealth graph and the global risk graph. The reality is that the global wealth graph of the world's wealthiest individuals and their networks have always had significant overlap with the global networks of individuals from a compliance risk standpoint.

David Leppan, founder of WorldCheck, one of the leading AML/KYC databases which was acquired by Thompson Reuters and now resides at Refinitiv, was the sole investor in my former company Wealth-X before we sold a majority stake to Insight Venture partners because he said he had made the black list in WorldCheck and wanted to help us create the Rich list in Wealth-X as the profiles were different but the business model was the same.

Yet, he always alluded to the fact that many of them would share both databases.

The 101 of AML and KYC compliance risks. At the core of AML and KYC are sanction lists of individuals published by various governments and governmental organizations. It is illegal to do business and there is swift retribution for those that do business with individuals on these lists.

As a summary for beginners, anti-money laundering (AML) encompasses the systems and steps that financial institutions undergo to ensure that no illicit funds from criminals are deposited or transferred through their institution.

AML is particularly focused on areas such as terrorist financing and trafficking.

Know Your Customer, or KYC, revolves around confirming the proposed identity of a potential customer and ensuring that the individual is who she says she is.

KYC is a subset of AML. Client due diligence is also a component of KYC and takes into account the likelihood of whether they might be likely to be involved in money laundering based on factors such as their country of origin or residency along with the type of account that they are seeking to open.

Many luxury brands are aware of these issues and some might have already been contacted by financial crimes units in their respective country around specific transactions. But most luxury brands have yet to build a comprehensive capability to address this growing challenge.

The key trend is that globally wealth is becoming more polarized and those who are aggregating the wealth at the top have become exponentially more wealthy and in search of ways to spend that wealth.

As more global wealth pours into the U.S. and other countries, luxury brands will need to recruit and build capabilities and skills around what will only become a more pressing challenge.

Most brands have been reactive about these issues and focused on reputation risk for an oligarch carrying a luxury item captured in a picture by the press, coupled with highly developed corporate social responsibility campaigns that are often decoupled from their retail sales organizations.

AS GLOBAL WEALTH finds its way into global and various asset classes, the confrontation between the global wealth graph and the global risk graph is inevitable.

My recommendation, if you are an executive at a luxury brand, would be to hire a compliance officer from a bank to start to formulate a strategy and roadmap. Better to get ahead of this than behind it.

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