FinCEN Targets "All Cash" Real Estate Deals in Manhattan and Miami

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On January 13, 2016, the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of Treasury (Treasury), as part of its continued efforts to combat money laundering, issued its first Geographic Targeting Orders (GTOs) of 2016. The GTOs are directed exclusively at U.S. title insurance companies and their subsidiaries and agents, requiring them, for a temporary period, to identify the individuals behind any entity that is used to purchase high-end residential real estate in Manhattan (New York) and Miami-Dade County (Florida) on an "all cash" basis. This alert addresses the immediate impact of these GTOs on the title insurance companies, and previews what the GTOs may mean for the real estate industry more broadly.

What is a GTO?

FinCEN uses GTOs to impose certain additional recordkeeping and reporting requirements on domestic financial institutions or nonfinancial trades or businesses located in a specific geographic area to collect and analyze financial data and to make such data available to law enforcement. The current GTOs have been issued following recent significant focus on the use of limited liability companies, partnerships, trusts, and other structures to purchase luxury real estate, thereby avoiding the need to disclose the ultimate direct or indirect individual owners of such entities.

FinCEN previously prioritized its real estate focused anti-money laundering protections on residential mortgage loans made by financial institutions and in February 2012 added anti-money laundering (AML) program and reporting requirements for non-bank residential mortgage lenders (mortgage companies) and originators (mortgage brokers). Now, the focus has turned to "all cash" residential purchases—at least preliminarily in Manhattan and Miami-Dade County.

Although FinCEN's issuance of these GTOs is aimed at collecting data, primarily to understand the money laundering vulnerabilities and inform its rulemaking, those operating in the real estate sector should be aware of the changing legal landscape under the Bank Secrecy Act (BSA), 31 U.S.C. § 5311, *et seq.,* and heightened scrutiny aimed at identifying the ultimate owners (and their sources of cash). Further, although these GTOs are initially directed at title insurance companies and are temporary in duration, nothing precludes FinCEN from eventually casting a wider net (to cover brokers, advisors, attorneys, or others operating in the high-end residential markets), lengthening the reporting period, or broadening the geographic areas covered.

What Will Be Required Under These GTOs?

Currently, these GTOs are directed only to U.S. title insurance companies and their subsidiaries and agents, and do not apply to other parties typically involved in real estate transactions, such as real estate brokers and appraisers. Likely, this is because most purchasers obtain title insurance coverage and use title companies to hold deposits, hold or wire funds, or submit deeds and other recordable documents for recordation—thereby putting them more readily in the position of being able to determine the ultimate owners and the origin of funds.

Title insurance companies will be required to file with FinCEN a Form 8300[1] within 30 days of closing, identifying the true "beneficial owners" of limited liability companies or other entities that pay—in cash, certified check, cashier's check, traveler's check, or a money order in any form—$1 million or more for homes in Miami-Dade County and $3 million or more for homes (including condominium units) in Manhattan. Title insurance companies must obtain and record a copy of the individual's driver's license, passport or other similar identifying documentation. The insurance companies are also required to retain all records obtained in compliance with the GTOs for five years and to make such records available to FinCEN or any other law enforcement or regulatory agency, upon request. The GTOs will take effect March 1, 2016 and continue for 180 days, expiring on August 27, 2016.

We note that, practically speaking, the reporting requirements will more likely be triggered in the context of luxury condominiums and individual home purchases, rather than in the context of "co-op" apartment purchases because the boards of cooperative apartment buildings tend to control or monitor more closely (and impose restrictions on) the identity of the ultimate purchaser and/or occupant.

Impact on "Persons involved in Real Estate Closings and Settlements"

The BSA, as augmented by several other Acts, including the USA Patriot Act of 2001, requires all "financial institutions" to maintain customer identification procedures and AML programs. (See 31 C.F.R. § 1010.620.) AML programs generally require (i) the development of internal policies, procedures and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test them.

Under the BSA, the term "financial institution" is broader than just banks and credit unions, and expressly includes entities such as brokers or dealers, insurance companies, loan companies, currency exchanges, finance companies, operators of credit card systems, pawnbrokers, and dealers of precious metals, stones or jewels. (See 31 U.S.C. § 5312(a)(2)(A)-(Z).) The term also encompasses "persons involved in real estate closings and settlements." (See 31 U.S.C. § 5312(a)(1)(U).) While AML programs have long been

[1] Form 8300, *Report of Cash Payments over $10,000 Received in a Trade or Business*, is a joint form issued by the Internal Revenue Service and FinCEN to track cash transactions over $10,000.

required of certain financial institutions such as banks and mortgage lenders, the broad category of "persons involved in real estate closings and settlements" was temporarily exempted in 2002 from the requirement to establish AML programs.[2] The stated reason for the exemption was to enable Treasury and FinCEN to study the affected industries and to consider the extent to which AML program requirements should be applied to them.

A real estate closing or settlement is generally understood to mean the process by which the purchase price is paid to the seller and title is transferred to the buyer. Certain parties are integral to the process, but because Section 5312(a)(1)(U) uses the phrase "persons involved in real estate closings and settlements," the statute could arguably apply to many more participants in addition to lending institutions, including mortgage brokers, real estate brokers, attorneys, title insurance companies, escrow agents, and appraisers.

As of today, the exemption remains in place, but the increased focus on the money laundering risks associated with real estate transactions is likely to result in FinCEN's reevaluation of that exemption. FinCEN's recent GTOs are a step in that direction.

Real Estate: A Known Money Laundering Risk

Since granting the exemption in 2002, FinCEN has monitored the money laundering risk in real estate and issued reports about that risk. As recently as November 2015, FinCEN highlighted that it continues to see the use of shell companies by international corrupt politicians, drug traffickers and other criminals to purchase luxury residential real estate in cash. FinCEN has also been urged by numerous organizations to repeal the 2002 temporary exemption and require that the real estate industry verify identities of buyers and screen them for potential money laundering risks.

Implications for the Real Estate Sector and Their Employees

Coverage under the BSA is expanding, and, significantly, the new GTOs are consistent with FinCEN's August 2014 notice of proposed rulemaking relating to *Customer Due Diligence Requirements for Financial Institutions* that would require financial institutions to conduct due diligence on legal entity customers similar to the requirement for individual customers.[3] Persons involved in real estate should monitor the BSA landscape for a possible expansion of the scope of GTOs and modifications to the exemption which would trigger reporting, AML obligations, and potential due diligence requirements to identify the beneficial owners of corporate entities.

In the interim, persons involved in real estate transactions need to be mindful of red flags that warrant closer scrutiny before they participate in the transaction. Red flags might include, for example:

- closing on an "all cash" basis;
- the use of legal entities without disclosure of all beneficial owners;
- purchases in which all identification presented is foreign, or difficult to verify;

[2] Other financial institutions granted exemptions under the BSA for the establishment of AML programs include those in the following categories: (i) pawnbroker; (ii) travel agency; (iii) telegraph company; (iv) seller of vehicles, including automobiles, airplanes, and boats; (v) private banker; (vi) commodity pool operator; (vii) commodity trading advisor; and (viii) investment company. *See* 31 C.F.R. § 1010.205(b).

[3] See Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151 (proposed Aug. 4, 2014).

- multiple real estate purchases in a short time frame by the same entity;
- property purchased without inspection;
- buyers rushing to complete the transaction;
- buyer's lack of concern regarding risks, fees or related transaction costs;
- the balance of closing costs satisfied by offshore bank accounts;
- completely anonymous transactions using attorneys and attorneys' trust accounts; or
- foreign or non-resident parties to the transaction whose sole purpose is capital investment (with no intent to reside at the property).

Although any of these red flags could have a legitimate basis, persons involved in real estate need to be aware of the use of real estate to launder proceeds of illicit activity and carefully assess each transaction for indications of money laundering. The GTOs are a new sign that regulators and prosecutors will be looking closely at these transactions. If persons involved in real estate closings and settlements observe any of these red flags, further inquiries should immediately be made. If not satisfied with the answers, persons involved in real estate closings and settlements should seriously consider declining to handle the transaction. Prosecutors are likely to view failure to do so as evidence of potential willful blindness and aiding and abetting money laundering.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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