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FinCEN Imposes Anti-Money Laundering Reporting Requirements On "All Cash" Luxury Real Estate Purchases in Manhattan and Miami

The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued Geographic Targeting Orders ("GTO") imposing temporary reporting requirements on title insurers with respect to "all-cash" purchases of high-end residential real estate in Manhattan and Miami-Dade County. Among other things, title insurers are required to identify the beneficial owners (i.e. natural persons) of the companies that purchase this real estate. These orders, following the 2012 anti-money laundering (AML) requirements imposed on non-bank mortgage lenders and brokers, point to FinCEN's continued expansion into the real estate sector.

BACKGROUND ON FINCEN'S PRIOR ACTIVITY IN THE REAL ESTATE SECTOR

Entities defined by FinCEN regulations as "financial institutions" are subject to the Bank Secrecy Act's ("BSA") requirement to establish an effective anti-money laundering program, which includes (1) implementing policies, procedures and internal controls, (2) designating a compliance officer, (3) providing on-going training and (4) arranging independent testing of their AML program. Many of these entities are also required to file Suspicious Activity Reports ("SARs") with FinCEN regarding potentially-suspicious transactions they observe.

FinCEN has exempted "persons involved in real estate closing and settlements"—including title insurers—from the requirement to maintain an AML program and file SARs.[1] Nevertheless, FinCEN has long recognized that real estate had been used for money laundering and in 2003, FinCEN sought public comment on applying AML program requirements to these entities.[2] The initiative, however, was met with significant resistance and FinCEN never issued a final rule on the subject. Title insurers are nevertheless subject to the BSA's recordkeeping and reporting requirements with respect to cash transactions greater than $10,000, and some even voluntarily file SARs despite the absence of a BSA obligation to do so.

In 2012, FinCEN lifted the exemption that applied to non-bank residential mortgage lenders and originators, thus subjecting them to AML program and SAR filing requirements. This action was

[1] See 31 C.F.R. § 1010.205.

[2] *See* Advanced Notice of Proposed Rulemaking, 69 Fed. Reg. 17569 (April 10, 2003).

motivated by FinCEN's finding that "independent mortgage lenders and brokers originated many of the mortgages that were the subject of bank SAR filings."[3] With both bank and non-bank mortgage lending covered, however, FinCEN perceives that a regulatory "gap" remains for cash real estate purchases. FinCEN has sought to address this gap with its recent GTO orders, as discussed below.

GEOGRAPHIC TARGETING ORDERS – MANHATTAN AND MIAMI

Under the BSA, the Treasury Department has the authority to issue GTOs that require all identified businesses, in this case title insurers, that exist within a geographic area to report on any transactions greater than a specified value.[4] Each order can last up to 180 days and can be renewed.[5] There are civil and criminal penalties for failing to comply with a GTO's requirements. In the last two years, specific money laundering concerns have motivated FinCEN to issue GTOs in several areas, including covering armored cars crossing the US/Mexico border[6] and transactions with garment and textile businesses in Los Angeles' fashion district.[7]

On January 6, 2016, FinCEN issued GTOs covering luxury "all cash" real estate purchases in Manhattan and Miami. These orders were motivated by the agency's concern that "all cash purchases—i.e. those without bank financing—may be conducted by individuals attempting to hide their assets and identity by purchasing residential properties through limited liability companies or other opaque structures."[8] The director of FinCEN, Jennifer Shasky Calvery, stated that FinCEN is seeking to understand the risk that "corrupt foreign officials, or transnational criminals, may be using premium U.S. real estate to secretly invest millions in dirty laundry."[9] FinCEN's actions follow several years of news reporting in cities, including New York and Miami, on the prevalence of shell companies being used to purchase high-end real estate and the secrecy surrounding these transactions. The *New York Times* reported that, across the

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3 FinCEN Requires AML Program and SAR Filing for Non-Bank Mortgage Lenders and Originators Reporting Would Assist Law Enforcement with Fraud Detection, Press Release, Feb. 7, 2012 https://www.fincen.gov/news_room/nr/pdf/20120206.pdf.

4 31 U.S.C. §5326(a).

5 By its terms, 31 U.S.C. § 5326(a) empowers the Secretary of the Treasury to impose obligations not just on financial institutions, but also on "nonfinancial trade or business." As a result, Section 3126(a) may require entities not ordinarily subject to the BSA's AML obligations, to implement similar AML programs.

6 FinCEN Renews and Broadens Geographic Targeting Orders on Border Cash Shipments in California and Texas, Press Release, Aug. 7, 2015, https://www.fincen.gov/news_room/nr/html/20150807.html.

7 FinCEN Issues Geographic Targeting Order Covering the Los Angeles Fashion District as Part of Crackdown on Money Laundering for Drug Cartels, Press Release, Oct. 2, 2014, https://www.fincen.gov/news_room/nr/html/20141002.html.

8 FinCEN Takes Aim at Real Estate Secrecy in Manhattan and Miami, Press Release , Jan. 13, 2016, https://www.fincen.gov/news_room/nr/html/20160113.html.

9 *Id.*

"United States in recent years, nearly half the residential purchases of over $5 million were made by shell companies rather than named people."[10]

Specifically, the GTOs impose temporary reporting requirements on certain title insurers for transactions in which (1) a legal entity; (2) purchases residential real property located either in Manhattan or Miami-Dade County; (3) for a total purchase price in excess of $3,000,000 or $1,000,000, respectively; (4) such purchase is made without a bank loan or other similar form of external financing and (5) such purchase is made, at least in part, using currency or a cashier's check, a certified check, a traveler's check, or a money order in any form. The GTOs do not specify the types of residential real properties, i.e. condominiums, single and multi-family homes, that trigger the reporting requirement.

To comply with the orders, title insurers must file FinCEN form 8300. In addition to requiring information about the real estate transaction, including the purchase price and the date on which the purchase amount was received, the form also requires information about "the identity of the individual primarily responsible for representing the purchaser," "the identity of the purchaser" and "the identity of the beneficial owner." The orders do not define or specify who the "individual primarily responsible for representing the purchaser" is, but define "beneficial owners" as individuals "who, directly or indirectly, own 25 percent or more of the equity interests of the Purchaser."[11] Copies of the individual's driver's license, passport or other identifying information are required. Importantly, if the purchaser is a limited liability company, the title insurer must provide "the name, address, and taxpayer identification number of all of its members, to the extent not otherwise provided on the Form 8300." Title insurers are required to retain all records relating to compliance with these orders for a period of five years.

As noted, the GTOs are of limited duration—from March 1, 2016 until August 27. FinCEN has stated that if the GTOs uncover serious evidence of money laundering, the program could be extended in time and expanded in scope across the country.

FinCEN stated that the data to be provided by the title insurers will be added to its database and shared with other law enforcement agencies, though it would not be made public.

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[10] Stream of Foreign Wealth Flows to Elite New York Real Estate, *New York Times*, Feb. 7, 2015 http://www.nytimes.com/2015/02/08/nyregion/stream-of-foreign-wealth-flows-to-time-warner-condos.html?rref=collection%2Fnewseventcollection%2Fshell-company-towers-of-secrecy-real-estate&action=click&contentCollection=us&region=rank&module=package&version=highlights&contentPlacement=1&pgtype=collection.

[11] In August 2014, FinCEN issued a Notice of Proposed Rulemaking to introduce a beneficial owner identification requirement to the customer due diligence (CDD) obligations under the BSA for banks, brokers and other covered financial institutions. This proposal is still pending. *See* 79 Fed. Reg. 45151 (Aug. 4, 2014).

IMPLICATIONS

The GTOs put significant compliance obligations on affected title insurers and will subject them to various potential forms of civil and criminal liability. In addition to civil and criminal liability under the BSA for failure to comply with the terms of the GTO, the knowledge that title insurers are required to gather about beneficial ownership could potentially subject them to other forms of liability.

Most fundamentally, title insurers will need to implement policies to identify the "natural" person or persons who are the ultimate buyers of these luxury properties. As noted, title insurers are not required to report suspicious transactions, but, in light of the additional information that must be gathered pursuant to the GTOs, they may feel compelled to expend additional resources to confirm the bona fides of covered transactions. Title insurers, like the general public, face the specter of criminal aiding and abetting liability for knowing involvement in illicit activity, including money laundering. Indeed, knowledge of the ultimate beneficial owner of a property may, under some circumstances, mean that a title insurer knows, or should know, that the transaction in question is connected to unlawful activity (e.g., political corruption or narcotics trafficking).[12] Similarly, title insurers that transact with entities whose beneficial owners appear on sanctions lists administered by Treasury's Office of Foreign Asset Control (OFAC) may face liability under the sanctions law regardless of their knowledge of the beneficial owners, but knowledge and a lack of voluntary self-disclosure would contribute to such cases being deemed "egregious" violations and therefore likely subject them to harsher penalties.[13]

In sum, although FinCEN's orders require that title insurers provide only certain information about beneficial owners and other identifying information regarding the parties to a transaction, it seems likely that, in order to manage legal and reputational risk, title insurers may in some cases need to perform more robust investigations to satisfy themselves of the bona fides of the transactions and the various parties involved. Title insurers and others in the real estate industry will need to confront these risks in a competitive industry serving customers who, in many cases, value secrecy. In such an environment, industry groups can serve a valuable role in creating a culture of reporting.

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[12] Under 18 U.S.C. § 2 and relevant case law, companies may be liable as aiders and abettors by exhibiting a "willful blindness" to the illicit nature of a transaction, often interpreted as deliberate ignorance of criminal activity. *See, e.g., U.S.* v. *Whitehall*, 532 F.3d 746, 751-52 (8th Cir. 2008); *U.S.* v. *Wert-Ruiz*, 228 F.3d 250, 255-57 (3rd Cir. 2000).

[13] *See* 31 C.F.R. §501; 74 Fed. Reg. 57598 (Nov. 9, 2009) ("As currently structured, the base penalty calculation ensures that the base penalty for a voluntarily self-disclosed case will always be one-half or less than one-half of the base penalty for a similar case that is not voluntarily self-disclosed. This is intended to serve as an additional incentive for voluntary self-disclosure.").

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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