

Clients & Friends Memo

FinCEN Issues New Geographic Targeting Order for Shell Companies Purchasing High-End Residential Real Estate

August 28, 2017

In its latest effort to combat money laundering within the real estate sector, the Financial Crimes Enforcement Network (“FinCEN”) has issued a new Geographic Targeting Order (“GTO”) broadening its scrutiny of shell companies used to purchase luxury residential property in several key U.S. markets.¹ The new GTO, effective for 180 days beginning September 27, 2017, requires title insurance companies to identify the natural persons behind limited liability companies and other legal entities that are used to purchase high-end residential real estate, without bank financing, in select markets including New York City, Miami, Los Angeles, San Francisco, San Diego, San Antonio, and now Honolulu. In addition, the latest GTO applies not only to cash purchases but also to those made via wire transfer. At the same time, FinCEN published a new Advisory to Financial Institutions and Real Estate Firms and Professionals (the “Advisory”) discussing the risks associated with real estate transactions.² These efforts illustrate FinCEN’s continued interest in identifying money laundering risks inherent in the purchase of luxury residential real estate through shell companies, and may be a preview of broader and more permanent scrutiny going forward of title insurance companies, lenders, and the lawyers and agents who advise them.

I. Broader Reporting of Residential Real Estate Transactions

Under the Bank Secrecy Act (“BSA”) a “covered financial institution”³ is required to file a suspicious activity report (“SAR”) if it knows, suspects, or has reason to suspect a transaction involves funds derived from illegal activity.⁴ In addition, the BSA provides FinCEN authority to

¹ FinCEN Geographic Targeting Order (Aug. 22, 2017), available at <https://www.fincen.gov/sites/default/files/shared/Real%20Estate%20GTO%20Order%20-%2008.22.17%20Final%20for%20execution%20-%20Generic.pdf>.

² FinCEN Advisory to Financial Institutions and Real Estate Firms and Professionals, FIN-2017-A003 (Aug. 22, 2017), available at https://www.fincen.gov/sites/default/files/advisory/2017-08-22/Risk%20in%20Real%20Estate%20Advisory_FINAL%200508%20Tuesday%20%28002%29.pdf.

³ A covered financial institution includes “persons involved in real estate closings and settlements”; however, that term has not been interpreted to encompass individual buyers and sellers, real estate agents, brokers, or title insurers. 31 U.S.C. § 5312(a)(2)(U). While these entities are not required to file SARs under the BSA, they may do so voluntarily.

⁴ 31 U.S.C. § 5318(g).

impose additional reporting requirements (such as pursuant to the issuance of GTOs) relating to certain categories of transactions upon a finding by the Secretary of the Treasury that such steps are necessary to prevent evasions of the BSA's recordkeeping and reporting provisions.⁵ Historically, this was limited to transactions involving "coin or currency," but the recent enactment of the Countering America's Adversaries through Sanctions Act broadened this authority beyond cash transaction to apply to virtually any transaction designated by FinCEN.⁶

The current GTO stems from an initial order issued by FinCEN in January 2016 which applied only to certain areas within New York City and Miami.⁷ It required title insurance companies, and their subsidiaries and agents, to identify the "beneficial owner" behind a legal entity that purchased high-end residential real estate in cash and without a bank loan or other financing. It defined beneficial owner as a natural person who, directly or indirectly, owns 25% or more of the equity interests of the purchaser. In July 2016, FinCEN renewed the order and expanded it to include an additional four markets in California and Texas.⁸ Six months later, in February 2017, FinCEN renewed the GTO for another 180 days.

This latest development is one of FinCEN's most aggressive exercises of its GTO powers to date. The latest GTO applies to the existing six markets and expands to a seventh one in Hawaii, and applies not only to non-financed transactions paid in cash but also to those paid by check, money order, or wire transfer.⁹ For real estate purchases to which the GTO applies, the title insurance company is required to complete a FinCEN Form 8300 (Report of Cash Payments over \$10,000 Received in a Trade or Business)¹⁰ and file it electronically through FinCEN's e-filing system.¹¹ The filing must include the identity of the purchaser (as well as anyone representing the purchaser) and the beneficial owner(s), and a description of the identifying documents examined to verify such information (such as a driver's license or passport). It also must include the date of the sale, the

⁵ 31 U.S.C. § 5326(a); 31 C.F.R. § 1010.370; U.S. Department of the Treasury, Treasury Order #180-01 (July 1, 2014).

⁶ Public Law No. 115-44 (Aug. 2, 2017), available at <https://www.congress.gov/bill/115th-congress/house-bill/3364/text#toc-H96DAF0AFF3BB4F55A9973F196CC032DB>.

⁷ See Cadwalader Clients & Friends Memo, FinCEN Targets High-Value Real Estate Transactions in New York and Miami (Jan. 19, 2016), available at <http://www.cadwalader.com/resources/clients-friends-memos/fincen-targets-high-value-real-estate-transactions-in-new-york-and-miami>.

⁸ See Cadwalader Clients & Friends Memo, FinCEN Tightens the Screws on Money Launderers with Additional Scrutiny of High-Value Residential Real Estate Transactions (Aug. 1, 2016), available at <http://www.cadwalader.com/resources/clients-friends-memos/fincen-tightens-the-screws-on-money-launderers-with-additional-scrutiny-of-high-value-residential-real-estate-transactions>.

⁹ The GTO covers purchases of residential real property at certain dollar thresholds per location, including \$500,000 in Texas, \$1 million in Florida, \$1.5 million in the outer boroughs of New York, \$2 million in California, \$3 million in New York City, and \$3 million in Honolulu.

¹⁰ <https://www.irs.gov/pub/irs-pdf/f8300.pdf>.

¹¹ <http://bsaefiling.fincen.treas.gov/main.html>.

total purchase price and amount transferred, and the address of the property. Copies of the filing and all identifying documents must be retained by the title insurance company for five years following the expiration of the GTO.

II. Additional Guidance for the Real Estate Industry

Alongside the new GTO, the latest Advisory discusses what FinCEN views as money laundering risks associated with real estate transactions. It describes how high-end residential property is attractive to money launderers due to its appreciation in value over time, and its ability to shield illicit funds from market instability and currency fluctuations and the ability to “clean” large sums of money in a single transaction. Buying such properties in all-cash transactions with no mortgage permits a purchaser to avoid the anti-money laundering, sanctions screening, and reporting mechanisms utilized by financial institutions. And, by using a shell company such as a private corporation, a limited liability company, or a trust, a buyer could camouflage his or her identity and the source of funds. The Advisory also points out that, while the GTO applies only to residential real estate transactions, these risks apply equally to both residential and commercial real estate transactions.

The Advisory also encourages real estate brokers, escrow agents, title insurers, and other real estate professionals who are not required to file SARs to do so voluntarily, as they typically have a full picture of a particular transaction and are well-suited to identify potentially illicit activity. It lists a number of factors such individual should consider, including whether a transaction:

- lacks economic sense or has no apparent lawful business purpose (including purchases and sales that generate little to no revenue or are conducted with no regard to high fees or penalties);
- is used to purchase real estate with no regard for the property’s condition, location, assessed value, or sale price;
- involves funding that far exceeds the purchaser’s wealth, comes from an unknown origin, or is from or goes to unrelated individuals or companies; or
- is deliberately conducted in an irregular manner (such as attempting to purchase property under another name, or asking for records to be altered).

The Advisory also makes a point of stating repeatedly that SARs filed by such individuals are kept confidential, and that voluntary filers enjoy a safe harbor from civil liability.

III. Conclusion

FinCEN is clearly pleased with the results of its GTO program to date, and that is reflected in these latest efforts. According to the Advisory, over 30% of the real estate transactions reported under the GTO has involved a beneficial owner or purchaser who was identified in a separate SAR,

possibly linked to bribery, corruption, narcotics smuggling, or health care fraud. At FinCEN's 2017 Law Enforcement Awards ceremony, it celebrated an investigation that was begun "based largely on information gleaned from a FinCEN-issued" GTO.¹² Based on this, FinCEN is surely going to continue aggressive GTO efforts, potentially continuing to expand to new markets and applying it to commercial as well as residential transactions. These efforts are likely to continue alongside upcoming requirements – effective May 2018 – that banks and other financial institutions identify a legal entity's beneficial owner at the time it opens a new customer account.¹³ FinCEN clearly views transparency around beneficial ownership as vital to combating money laundering, and financial institutions, and the legal and compliance professionals who support them, should plan accordingly.

* * * * *

Please feel free to contact any of the following Cadwalader lawyers if you have any questions about this Clients & Friends Memo.

| | | |
|----------------------|-----------------|--|
| Jodi L. Avergun | +1 202 862 2456 | jodi.avergun@cwt.com |
| Steven M. Herman | +1 212 504 6054 | steven.herman@cwt.com |
| Joseph V. Moreno | +1 202 862 2262 | joseph.moreno@cwt.com |
| Jonathan Bailyn | +1 202 862 2336 | jonathan.bailyn@cwt.com |
| Nicholas E. Brandfon | +1 212 504 6039 | nicholas.brandfon@cwt.com |

¹² FinCEN Press Release, "FinCEN Awards Recognize Law Enforcement Success Stories Supported by Bank Secrecy Act Reporting" (May 9, 2017), available at <https://www.fincen.gov/news/news-releases/fincen-awards-recognize-law-enforcement-success-stories-supported-bank-secrecy>.

¹³ See Cadwalader Clients & Friends Memo, In Wake of the Panama Papers, Treasury Proposes New Reporting Requirements for Foreign-Owned Legal Entities (May 18, 2016), available at <http://www.cadwalader.com/resources/clients-friends-memos/in-wake-of-the-panama-papers-treasury-proposes-new-reporting-requirements-for-foreign-owned-legal-entities>.