

Client Alert

August 2017

FinCEN Expands Its Geographic Targeting Orders (GTOs) to Include High-End Residential Real Estate Purchases Made Using Wire Transfers and Issues Related Advisory to Financial Institutions and the Real Estate Industry

On August 22, 2017, FinCEN expanded the reporting obligations of title insurance companies by issuing revised Geographic Targeting Orders (GTOs) that target “all-cash” purchases by shell companies of high-end residential real estate in seven specified metropolitan areas. FinCEN’s latest GTOs contains two significant changes from the previous GTOs issued by FinCEN earlier this year. First, the city and county of Honolulu, Hawaii, has been added to the list of targeted geographic areas, joining Manhattan and all New York City boroughs, Miami and surrounding metropolitan areas, five counties in California (including Los Angeles, San Francisco and San Diego) and the Texas county that includes San Antonio. The second and perhaps most significant change is the capture of high-end residential real estate transactions involving the use of funds transfers, including wire transfers. Due to former limitations in FinCEN’s authority to impose additional recordkeeping and reporting requirements, previous GTOs captured only transactions involving “coin and currency”¹—but not funds/wire transfers—potentially resulting in a significant gap in FinCEN’s efforts to curb the laundering of illegal proceeds through the use of shell companies to purchase luxury properties. Following the enactment of the Countering America’s Adversaries Through Sanctions Act in early August—and subsequent amendments to 31 U.S.C. §5326—FinCEN is now able to close this gap and include high-end residential real estate purchases made using funds transfers.

Concurrently, with the issuance of the revised GTO, FinCEN issued a related Advisory to Financial Institutions and Real Estate Professionals (FIN-2017-A003). The advisory provides guidance to financial institutions, which are defined by the Bank Secrecy Act (BSA) to include “persons involved in real estate closings and settlements,” on the money-laundering risks associated with the purchase of high-end residential real estate, as highlighted by the revised GTO. FinCEN’s advisory encourages financial institutions subject to suspicious activity reporting (SAR) requirements to keep in mind the risks associated with all-cash purchases by shell companies of high-end residential real estate when identifying and reporting suspicious transactions. Additionally, FinCEN encourages real estate brokers, escrow agents, title insurers and other real estate professionals—who are not subject to mandatory SAR requirements—to file voluntary SARs involving real estate purchases and sales.

FinCEN’s Revised GTOs Targeting “All-Cash” High-End Residential Real Estate Purchases

Pursuant to the authority provided by 31 U.S.C. §5326, 31 CFR §1010.370 and Treasury Order 180-01, FinCEN may issue orders (i.e., the GTOs) that impose additional recordkeeping and reporting requirements on one or more domestic financial institutions or nonfinancial trades or businesses in a geographic area. The revised GTOs require title insurance companies, and any of their subsidiaries or agents, to file FinCEN Form 8300 within 30 days following the closing of a specified “covered transaction”

¹ Cash includes cashier’s checks, bank drafts, traveler’s checks, personal checks or money orders in any form.

involving the purchase of residential real estate. For a transaction to be a “covered transaction,” it must involve the purchase by:

1. a legal entity (defined as a US or foreign corporation, limited liability company (LLC), partnership or other similar business entity);
2. of residential real property in any of the following geographic areas and for the total purchase price of:
 - a. \$500,000 or more in the Texas county of Bexar;
 - b. \$1,000,000 or more in the Florida county of Miami-Dade, Broward or Palm Beach;
 - c. \$1,500,000 or more in the borough of Brooklyn, Queens, Bronx or Staten Island in New York City, New York;
 - d. \$2,000,000 or more in the California county of San Diego, Los Angeles, San Francisco, San Mateo or Santa Clara;
 - e. \$3,000,000 or more in the borough of Manhattan in New York City, New York;
 - f. 3,000,000 or more in the city and county of Honolulu in Hawaii;
3. without a bank loan or other form of external financing; and
4. made, at least in part, using a funds transfer, or currency or a cashier’s check, a certified check, a traveler’s check, a personal check, a business check or a money order in any form.

Title insurance companies filing FinCEN Form 8300 must include certain information regarding the covered transaction, including information about:

1. the identity of the individual primarily responsible for representing the legal entity purchasing the residential real estate (and must obtain and record a copy of this individual’s driver’s license, passport or other similar identifying documentation);
2. the identity of the legal entity;
3. the identity of the beneficial owner(s)² of the legal entity (and must obtain and record a copy of the beneficial owner’s driver’s license, passport or other similar identifying documentation);
4. information about the covered transaction; and
5. information about the title insurance company itself.

In terms of recordkeeping, the revised GTOs require title insurance companies to retain all records “relating to compliance with [the GTOs]” for five years from the last day the GTO is effective (including any renewals of the GTOs—see below for the effective period); store the records in a manner accessible within a “reasonable period of time”; and make the records available to FinCEN or other appropriate law enforcement or regulatory agencies, upon request.

With respect to compliance with the GTOs, title insurance companies must supervise, and are responsible for, compliance by its officers, directors, employees and agents with the terms of the revised GTOs. A title insurance company must transmit the GTOs to its CEO (or equivalent manager), and to each of its agents.

FinCEN’s revised GTO is effective September 22, 2017, and ends on March 20, 2018, but as we have seen, FinCEN may renew the GTOs or issue revised GTOs prior to their expiration.

FinCEN Advisory to Financial Institutions and Real Estate Professionals (FIN-2017-A003) – August 22, 2017

Concurrent with the revised GTOs, FinCEN issued an advisory to provide financial institutions and the real estate industry with information on money laundering risks associated with all-cash/no-financing purchases of luxury property using shell companies. As with previous advisories, FinCEN emphasizes the

² A “beneficial owner” is defined as each individual who, directly or indirectly, owns 25 percent or more of the equity interests of the legal entity purchasing the residential real property.

need for transparency in customer transactions, and notes that real estate transactions often involve high-value assets, opaque entities and complex or diverse processes that can limit such transparency. These and other characteristics of real estate transactions—such as the appreciation of real estate, the ability to “clean” large amounts in a single transactions and the stability of the real estate market—make real estate purchases an attractive vehicle to criminal actors seeking to conceal the existence and origin of their illicit funds.

The advisory focuses on two particular money laundering risks in real estate transactions—which are both highlighted by the revised GTOs. The first is the use of shell companies to purchase the high-end residential real estate. Shell companies—such as special purpose LLCs with no physical presence beyond a mailing address—can often be formed and put into use very quickly, without the need to disclose any of the individuals that own or control the company (i.e., the beneficial owners). While many shell companies—such as special purpose LLCs—are formed and utilized for legitimate business purposes, criminal actors often abuse the anonymity provided by such companies to mask their identities, involvement in real estate transactions and origins of their illicit wealth. When coupled with the second money laundering risk identified in the advisory—the use of all-cash/no-financing to purchase real estate—such real estate transactions become a significant hindrance to law enforcement.

As the advisory states, when real estate is purchased using “all-cash” and no-financing, criminal actors can often evade the customer due diligence and source of their wealth verification that a financial institution would be required to perform under the BSA as part of a loan/mortgage application process. While not all all-cash real estate purchases, of course, involve criminal actors, the nature and process of all-cash transactions provide a vehicle for exploitation by criminal actors looking to disguise their illicit wealth.

The advisory also provides some eye-opening facts regarding data it has collected from GTOs issued in 2016 and 2017. In particular, FinCEN notes that over 30 percent of the real estate transactions reported under the GTOs involved a beneficial owner—or an individual representing the shell company—that had been the subject of an unrelated SAR filed by US financial institutions. Put another way, in nearly one-third of all real estate transactions reported under the GTOs, a US financial institution had *already* identified and reported suspicious activity by a beneficial owner or shell company representative involved in the transaction.

Finally, FinCEN encourages financial institutions subject to SAR requirements to pay close attention to the money-laundering risks posed by all-cash/no-financing real estate purchases using shell companies, and to identify any suspicious activity by filing a SAR that references the advisory and includes the key term “ADVISORY REAL ESTATE” in the SAR narrative and in SAR field 33(z). Similarly, FinCEN encourages real estate professionals—including real estate brokers, escrow agents and title insurers—that may not be subject to SAR requirements to nevertheless file voluntary SARs in the same manner to indicate a connection between the suspicious activity reported and the real property.

Action Plan

Given the susceptibility of these transactions to potential money-laundering activity, and the expanded reporting requirements, financial institutions, title insurance companies and real estate firms/professionals should review their compliance policies and procedures, as well as their internal controls, as follows:

Financial Institutions—including depository institutions and loan or finance companies—should ensure their transaction monitoring systems and detection scenarios are properly tuned to effectively detect and identify suspicious activity involving the all-cash purchase, via funds/wire transfer, of high-end real estate by shell companies in the targeted geographic areas. In addition, financial institutions should review and revise as appropriate their customer due diligence policies, procedures, controls and training relating to legal entities, including shell companies, and assure that they collect beneficial ownership information as required by FinCEN’s new customer due diligence requirements applicable to all financial institutions on May 11, 2008. Finally, financial institutions must ensure they investigate all instances of suspicious

activity involving the all-cash/no-financing purchases of high-end residential real estate by shell companies, and that they promptly file SARs, as appropriate, referencing FinCEN's advisory on high-end real estate purchases.

Title insurance companies should ensure they have the proper policies, procedures and controls to comply with all the recordkeeping and reporting requirements of FinCEN's revised GTOs, including revising existing policies, procedures and controls to add the geographic target area of Honolulu, Hawaii, and to capture the use of funds/wire transfers in all-cash purchases of high-end residential real estate by shell companies. Title insurance companies should also ensure that their officers, directors, employees and agents are trained on the requirements of FinCEN's revised GTOs and their internal policies, procedures and controls to ensure compliance with the same.

Real estate firms and professionals—including real estate brokers, escrow agents and title insurers—should consider developing and implementing a program, including policies, procedures and controls, to identify and report suspicious transactions involving all-cash purchases of high-end residential real estate by shell companies. The program should provide for appropriate training to their officers, directors, employees and agents on the money-laundering risks involved with purchases of high-end residential real estate, and provide an escalation process for any suspicious activity detected, and for the voluntary filing of SARs with FinCEN, as appropriate. In light of the SAR data cited in the advisory and the continued focus on beneficial ownership disclosure, we expect FinCEN to continue to expand the scope of AML requirements in real estate.

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