How FinCEN Proposal Expands RE Transaction Obligations

By **Michael Gershberg, Michael Werner and Gregory Bernstein** (March 14, 2024)



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On Feb. 16, the U.S. Department of the Treasury's Financial Crimes Enforcement Network issued a proposed rule that would impose a new reporting requirement for certain nonfinanced residential real estate transfers.

The rule is intended to improve transparency in an industry the U.S. government views as at high risk for money laundering activity by requiring reporting of such transactions and the disclosure of the beneficial owners of buyer entities.

Although the proposed rule is limited to residential real estate transfers, FinCEN intends to issue another proposed rule to address money laundering concerns in the U.S. commercial real estate sector later this year.

This article will explain the regulatory context for this FinCEN initiative, summarize the main requirements of the proposed rule, and provide key takeaways for real estate professionals.

Regulatory History and Context

The Bank Secrecy Act has long included within its scope "persons involved in real estate closings and settlements."

However, FinCEN has exempted such persons from comprehensive anti-money laundering regulation. Instead, FinCEN has taken a more targeted approach to AML regulation in the real estate sector.

Beginning in January 2016, FinCEN issued geographic targeting orders covering high-end, all-cash residential real estate purchases in certain markets. FinCEN has praised these geographic targeting orders, which have been renewed and expanded several times since 2016, as a valuable tool for helping law enforcement target illicit activity.

The proposed rule builds upon and significantly expands the geographic targeting orders, since the proposed rule would apply nationwide and would not have any purchase price threshold.

The expansion of AML regulatory requirements into the real estate sector has been previewed for some time.

Just last year, FinCEN Director Andrea Gacki told industry leaders that "the U.S. real estate market has been susceptible to manipulation and use as a haven for the laundered proceeds of illicit activity, including corruption."

Accordingly, FinCEN intended to issue new regulations to combat money laundering and illicit finance risks in the real estate market.

At the same time, FinCEN has sought to expand the reach of its AML regulations in other areas. For example, the agency recently announced a proposed rule that would subject investment advisers to certain Bank Secrecy Act obligations, including the requirement to maintain an AML program and file suspicious activity reports.

This flurry of rulemaking comes on the heels of the U.S. Department of the Treasury's release of the annual National Money Laundering Risk Assessment, which summarizes the current money laundering environment and seeks to guide policy deliberations by the U.S. government.

Some of the recent policymaking related to AML is likely motivated by the connection between money laundering and sanctions evasions by Russian oligarchs, drug traffickers and malicious cyber actors.

These connections, which are detailed at length in the NMLRA, add a national security dimension to the fight against money laundering. In this way, today's environment reflects the phenomenon that existed in the early 2000s, when U.S. AML laws and regulations were strengthened by the Patriot Act in order to combat the financing of terrorism, which was the illicit finance focus of that period.

With this backdrop, the proposed rule seeks to counter that money laundering vulnerabilities of the U.S. residential real estate market.

Covered Residential Real Estate Transfers

The basic structure of the proposed rule is a requirement for certain persons involved in the closing and settlement of real estate transactions to file a streamlined suspicious activity report within 30 days after the transfer of certain residential real estate. However, the proposed rule contains a number of limitations that narrow its scope.

First, the proposed rule only covers transfers of (1) U.S. real property designed principally for occupancy by one to four families; (2) vacant or unimproved land that is zoned, or for which a permit has been issued, for occupancy by one to four families; and (3) shares in a cooperative housing corporation. It is focused on individual home investments, not commercial investments in apartment buildings.

Second, the proposed rule only applies when the transfer does not involve an extension of credit to all transferees that is (1) secured by the transferred property, and (2) extended by a financial institution that is required to maintain an AML program and report suspicious activity under the Bank Secrecy Act.

Therefore, the proposed rule applies to all-cash purchases, as well as those financed by lenders other than regulated financial institutions. Like the existing geographic targeting orders, the proposed rule does not cover financed transfers because lenders already conduct legally required AML checks on buyers in those transactions.

The Treasury Department estimates that approximately 20% to 30% of residential real estate purchases in the United States are nonfinanced and may therefore be covered by the proposed rule.

Third, the proposed rule applies only to transfers to entities or trusts, not to individuals. For purposes of this rule, trusts exclude statutory trusts, a trust that is a securities reporting issuer, and a trust in which the trustee is a securities reporting issuer.

It is unclear from the text of the proposed rule whether it applies to an entity-level transfer of ownership interests in residential real estate, as distinguished from a transfer of title to the residential real estate itself. While the structure of the rule indicates that it only applies to transfers involving a real estate closing or settlement, this is an open question that may be clarified by FinCEN in the final rule.

Who Is Affected

The proposed rule establishes a multistep cascade process for determining who is the reporting person for a given reportable transfer. Specifically, the reporting person is determined in the following order, with each subsequent step only relevant if there is no such person described in the preceding steps involved in the transfer:

- The person listed as the closing or settlement agent on the closing or settlement statement for the transfer;
- The person that prepares the closing or settlement statement for the transfer;
- The person that files with the recordation office the deed or other instrument that transfers ownership of the residential real property;
- The person that underwrites an owner's title insurance policy for the transferee with respect to the transferred residential real property, such as a title insurance company;;
- The person that disburses in any form, including from an escrow account, trust account, or lawyers' trust account, the greatest amount of funds in connection with the residential real property transfer;
- The person that provides an evaluation of the status of the title; or
- The person that prepares the deed or, if no deed is involved, any other legal instrument that transfers ownership of the residential real property.

Additionally, any person that could be a reporting person, e.g., a settlement agent, may agree with any other person who could be a reporting person, e.g., the underwriter of an owner's title insurance property, to designate that person to report for a given transfer.

The proposed rule's focus on settlement and closing professionals reflects the findings from the NMLRA that persons involved in real estate closings and settlements are currently exempt from instituting and maintaining comprehensive AML programs and that this exemption "is a critical vulnerability, and real estate professionals have been found to act as both witting and unwitting participants in money laundering schemes."

Information to be Reported

The real estate report must identify and include information on the following:

- The reporting person;
- The legal entity or trust transferee;
- The beneficial owners of that transferee entity or transferee trust;
- The transferrer;
- The property being transferred; and
- The transfer itself.

The required information generally includes the person or entity's name, tax identification number, address for entities and trusts, and date of birth for individuals.

Regarding the transfer itself, the real estate report must include the address and a legal description of the property being transferred, the total consideration paid by the transferee, the name of any payors, and whether the transfer involved the extension of credit by any person that is not a regulated financial institution.

Transfers Not Subject to the Proposed Rule

The proposed rule contains exemptions for several types of transfers as well as certain categories of transferee entities.

Transfers in which all transferees are exempt entities would not trigger a reporting requirement.

Exempted transfers are those involving an easement, as well as transfers that occur as the result of the property's owner death, resulting from divorce, or that are made to a bankruptcy estate.

Exempt entities include public companies, U.S. government entities, banks, a range of regulated entities, and wholly owned or controlled subsidiaries of exempt entities.

These exempt entities are generally those that are already subject to AML and BSA requirements or are supervised by other federal regulations.

Notably, the list of exemptions is not the same as the list of entities that are exempt from the Corporate Transparency Act's beneficial ownership reporting regime.

The proposed rule does not exempt transfers to registered investment advisors or pooled investment vehicles or their subsidiaries unless they are controlled or wholly owned by an exempt entity.

FinCEN explained its decision to not make pooled investment vehicles exempt by noting that

"private funds have been used by sanctioned persons, corrupt officials, tax evaders, and other criminal actors as a gateway to the U.S. financial system."

Accordingly, the proposed rule may cover private fund investments in single-family homes if they are not financed.

Key Takeaways

The proposed rule, which has been under consideration for a number of years, would mark a dramatic expansion of the reporting obligations that are currently in place as part of FinCEN's geographic targeting order program.

It would create the first nationwide system for collecting information on nonfinanced residential real estate transfers.

Although some of the information that would be collected under the proposed rule would also be received under the Corporate Transparency Act's beneficial ownership information rule that took effect this year, FinCEN has stated that the proposed rule and the CTA's reporting regime serve different purposes.

Unlike the CTA, the proposed rule is intended as a tailored reporting requirement applicable only to a specific class of activity that the U.S. government views as having a high risk for money laundering activity.

Persons involved in the closing and settlement of real estate transactions, as well as those involved as a business in the purchase and sale of residential real estate, should carefully review the proposed rule and familiarize themselves with its requirements.

Public comments on the proposed rule can be submitted until April 16. The proposed rule's reporting requirements would not take effect until one year after a final rule is published, which makes it unlikely that the requirements would take effect before the second half of 2025, at the earliest.

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