

Anti-Money Laundering Risks in Real Estate Transactions

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The authors explain that, in general, those engaging in real estate transactions should carefully consider each transaction—specifically the parties involved, the sources of funding being used, and whether or not any “know your customer” diligence has been undertaken—and, applying common sense, consider whether anything seems unusual or concerning before closing the deal.

In the twenty-first century, in a rapidly globalizing world, money laundering has been an area of particular concern and regulatory focus. However, in spite of this heightened scrutiny, significant gaps exist that could allow money launderers to continue to get illicit funds into the United States financial system unless parties to real estate transactions are vigilant and cautious. In particular, although in recent years residential real estate transactions have been the subject of increased anti-money laundering focus, parties entering into real estate transactions should nevertheless pay close attention to the parties, sources of funds, and financing (or lack thereof) involved in these transactions and be on the lookout for red flags suggesting that a transaction may be suspect.

Background

Money laundering typically occurs in three steps. First, the money launderer must find a way to get the illegal proceeds into the financial system, often by breaking up the money into smaller transactions—a process known as “placement.” A money launderer might accomplish this, for example, through the purchase of money orders or other instruments. Next, the money launderer “layers,” or sets up shell companies, such as limited liability companies (“LLCs”), and non-U.S. accounts to obscure his, her, or its true identity and, in turn, the source(s) of the funds. Finally, the money launderer “integrates” the money by using it in a seemingly legitimate business endeavor. That business endeavor could be, for example, a commercial or even residential real estate purchase.

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Real Estate Transactions Are Desirable Vehicles for Money Laundering

Real estate transactions have several characteristics that make them uniquely suited for use by aspiring money launderers. First of all, real estate purchases, particularly those in commercial real estate, are generally investments of significant monetary size and thus allow a money launderer to move (or “integrate”) a large amount of ill-gotten money in a single transaction. In addition, the real estate market is usually relatively stable and real estate tends to appreciate over time, making it a generally fruitful investment, especially if property is rented out to tenants after purchase. Further, while real estate transactions may occur using mortgage brokers or involve other financial institutions, they do not have to - all-cash or partly-cash transactions can be used to obscure a buyer’s identity and evade the regulatory “know your customers” requirements imposed upon such institutions.

In addition, when purchasing real estate, it is not all that difficult for a buyer to conceal his, her, or its true identity, whereby real estate transactions are attractive to money launderers who may have obvious ties to illegal activities or corrupt regimes. Commonly, buyers seeking to remain anonymous use shell companies to purchase real estate so that they do not have to identify the source(s) of their funds or provide their true identities. LLCs can effectively be operated by companies that exist solely to assist beneficial owners in hiding their identities by serving as the LLCs’ directors, making the use of an LLC to purchase real estate a particularly effective way for a money launderer to hide within a real estate transaction.

Evolving Regulatory Efforts to Curb Money Laundering in Real Estate Transactions

The Bank Secrecy Act (the “BSA”) contains anti-money laundering provisions, including a requirement that regulated entities file Suspicious Activity Reports (“SARs”) when faced with suspicious transactions. However, while the BSA’s reach covers financial institutions involved in real estate transactions, as noted, not all real estate transactions actually involve such financial institutions. In particular, beyond the BSA’s reach are the significant number of real estate transactions that take place in cash or other non-mortgage instruments.

The United States government is not unaware of these risks. Since 2016, the United States Department of the Treasury has been working to combat money laundering in the real estate market through its Financial Crimes Enforcement Network (“FinCEN”). In early 2016, FinCEN issued its first Geographic Targeting Orders (“GTOs”), which require title insurance companies in the United States to engage in enhanced diligence efforts with respect to certain residential real estate transactions. In particular, the GTOs, which are effective for six months at a time and subject to renewal, require U.S. title insurance companies in certain geographic areas to identify and report the natural person owners (that is, “beneficial owners”) behind shell company buyers engaging in transactions of a certain monetary threshold that do not involve mortgages, bank loans, or other external financing but instead involve cash, cashier’s check, certified check, money order, traveler’s check, personal check, business check, funds transfer, or virtual currency. All individuals owning, whether directly or indirectly, 25 percent

or more of the equity interest in the purchasing entity are considered “beneficial owners” on whom identifying information must be collected and reported.

The first GTOs, issued in early 2016, targeted Manhattan and Miami-Dade county, two regions characterized by a large incidence of high-end residential real estate transactions occurring in cash. FinCEN has used the GTOs to monitor what it considers high risk geographic areas and has expanded the list of geographic areas covered by the GTOs over the past several years. The GTOs also have records retention requirements and dictate how the reporting must occur. Under the GTOs, any director, officer, employee, or agent of a title insurance company or subsidiary or agent thereof, as well as the company itself, can be held liable for unspecified “civil and criminal penalties” for violating the GTOs.

Effective as of November 12, 2019, FinCEN’s reissued GTOs maintain a monetary threshold of \$300,000 and cover certain counties within the metropolitan areas of Boston, Chicago, Dallas-Fort Worth, Honolulu, Las Vegas, Los Angeles, Miami, New York City, San Antonio, San Diego, San Francisco, and Seattle—the same threshold and geographic areas covered by the prior May 2019 GTOs. The November 2019 GTOs, however, unlike the GTOs that came before them, do not require reporting of purchases by U.S. publicly-traded companies, as these purchases can be identified through other filings of such businesses. These GTOs remain valid through May 9, 2020.¹

In order to comply with the GTOs, FinCEN has indicated that it expects title companies to “implement procedures reasonably designed

to ensure compliance with the terms of the GTOs, including reasonable due diligence” to determine whether the transaction falls within the terms of the GTOs and “to collect and report the required information.”² In complying, a title company may “reasonably rely” on third parties, including those involved in the transaction.³

The Risk of Money Laundering in Commercial Real Estate Transactions Remains Unchecked

Even though FinCEN has made significant strides in instituting oversight and even some regulation to transactions in residential real estate, FinCEN’s efforts have not brought an end to the use of real estate transactions for money laundering. In particular, commercial real estate transactions remain susceptible to money laundering schemes, as they share many of the same characteristics that make residential real estate transactions likely vehicles for money laundering but are thus far not covered by FinCEN’s GTOs. Commercial real estate transactions are often made through LLCs formed specifically to make such purchases and there is no regulatory scheme that requires the LLCs’ actual owners to be monitored or disclosed. Commercial real estate transactions are also, of course, generally very large and allow money launderers the opportunity to move a large amount of illicit proceeds quickly.

Considerations for Prudent Real Estate Transactions

Even with FinCEN’s oversight, anyone engaging in a real estate transaction should be weary of potential money laundering schemes. In particular, those transactions

involving non-U.S. buyers making all cash or largely cash purchases should raise red flags. In general, transactions in which a buyer opts not to involve a U.S. bank account, or does not have one, should cause particular concern, as U.S. banks are required to engage in their own “know your customer” diligence, which can provide a layer of regulatory comfort to those engaging in transactions with parties using such bank accounts. When the accounts used are not in the United States, the U.S. government can only inquire of the foreign government regarding the sources of the funds and that other government may not provide such information in a timely manner, if at all.

Other red flags a participant in a real estate transaction should be weary of include a buyer who does not care to actually visit, view, or learn about the property being purchased, a buyer whose funding is coming from a third party without a clear connection to the buyer, or a buyer who does not seem to care about

the price. In general, those engaging in real estate transactions should carefully consider each transaction—specifically the parties involved, the sources of funding being used, and whether or not any “know your customer” diligence has been undertaken—and, applying common sense, consider whether anything seems unusual or concerning before closing the deal. Because real estate transactions are still not impervious to money laundering risks, if the transaction seems suspicious, it very well just may be.

NOTES:

¹See <https://www.fincen.gov/sites/default/files/shared/Real%20Estate%20GTO%20Order%20FINAL%20GENERIC%2011.8.2019.pdf>.

²“Frequently Asked Questions,” Financial Crimes Enforcement Network, U.S. Department of the Treasury (Nov. 8, 2019), <https://www.fincen.gov/sites/default/files/shared/FAQs%20on%20Real%20Estate%20GTO%20FINAL%2011.8.2019.pdf>.

³See *id.*