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# Four Takeaways from Treasury's Draft Rule to Combat Money Laundering in U.S. Real Estate

On February 7, 2024, the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") proposed a new rule to combat money laundering, including laundering of the proceeds of corruption, through the United States' residential real estate sector. The Draft Rule details the types of sales or transfers that would be covered, as well as the associated requirements for a covered transaction.

1. **The Draft Rule would establish permanent anti-money laundering ("AML") requirements for transfers of residential real estate that involve a company or other legal entity—regardless of the value of the property or transfer.**

In our comment responding to FinCEN's Advance Notice of Proposed Rulemaking on this issue from December 2021, Transparency International U.S. ("TI US") stated that the U.S. Government's current, *temporary* and *location-specific* approach to combating money laundering through U.S. real estate—known as Geographic Targeting Orders, or "GTOs", wherein title insurance companies involved in cash-only purchases by legal entities of residential real estate properties valued above certain dollar thresholds in certain locations were required to report information about the actual persons purchasing the property—must be expanded to cover the entire United States, made permanent, and broadened to cover all transfers of residential real estate, regardless of the value of the property.

Fortunately, the Draft Rule adopts each of these recommendations, expressly acknowledging that the GTOs were "not a permanent solution to a nationwide problem" and that criminals seeking to launder dirty money do not "exclusively invest in luxury" property, but also clean their funds via low-value real estate. Particularly important to this conclusion is how the Draft Rule would thus apply to *gifts* of residential real estate, assuming the receiver of the gift is a company or other legal entity.

2. **The Draft Rule would set up a "cascading" order for identifying *who*—based on activities, not professions—must perform the required AML obligations.**

Big picture, the Draft Rule would create *filing* and *recordkeeping* requirements on one person involved in a covered transfer (known as the "reporting person"), who would be determined by a cascading reporting order (or by agreement among those described in the reporting order). Notably, this person would be determined by the *function* they perform in a given transfer (not simply by profession or industry).

The order of this cascade is:

(1) Those providing certain settlement services in the settlement process;
(2) The person who underwrites an owner's title insurance policy for the buyer/transferee;
(3) The person who disburses the greatest amount of funds in connection with the purchase or transfer (e.g., an escrow agent);
(4) The person that prepares an evaluation of the title status; and
(5) The person who prepares the deed.

The reporting person, once identified through the above scheme, would be required to file a "Real Estate Report" within 30 days of the purchaser receiving ownership of the property in question (and maintain a copy of that Report for 5 years). This Report would include:

(1) The name and business address for themselves, for the purchasing/transferee-ing entity, and for the selling/transferor-ing entities;
(2) The beneficial ownership information, as well as citizenship information, for all beneficial owners of a purchasing entity, individual seller/transferor, *and* individuals who are trustees of transferor trusts (note that the term "beneficial owner" would have the same meaning as that in the U.S.'s broader beneficial ownership reporting regime via the Corporate Transparency Act);
(3) A unique identifying number (e.g., IRS Taxpayer ID Number, foreign passport number) for each person whose name or address is required to be reported;
(4) The total amount (or other consideration) paid by all buyers, the method of payment, and the accounts and financial institutions used; and
(5) The address of the property, and a legal description thereof (e.g., the section, lot, and block).

Unfortunately, and contrary to the recommendations included in our comment, the Draft Rule does not require the reporting person to document the *source of funds* used by the purchaser(s) (including verifying the occupation and income of the purchaser—data that is collected in mortgage-financed transactions), or, and especially important with regard to efforts to combat transnational corruption, to report whether the purchaser is a *politically exposed person*, or PEP. PEPs are widely recognized by domestic and foreign law enforcement and regulators, and international standard-setting bodies, to be high-risk individuals regarding corruption and associated money laundering crimes. For example, the 2021 Global Financial Integrity report *Acres of Money Laundering* found that over 50 percent of surveyed cases involving money laundering in real estate involved a PEP.

3. **Commendably, the Draft Rule rejects many of the higher risk exemptions included in the U.S.'s broader beneficial ownership reporting rules (the Corporate Transparency Act).**

The Draft Rule does not include many of the higher risk exemptions included in the Corporate Transparency Act that limit the scope of the U.S.'s umbrella registry—meaning that corrupt and other illicit actors will have fewer means of evading AML checks by using uncovered entities to make purchases. Most importantly, the Draft Rule would cover purchases made by *trusts*.

As we stated in our comment, the Pandora Papers exposed how U.S. trusts are frequently used by corrupt and other criminal actors to purchase U.S. real estate, offering criminals a potentially "easy and exploitable loophole". Despite these known risks, the current GTO program has not been changed to cover them.

Fortunately, the Draft Rule, if finalized, would at long last end this notorious exemption, along with other exemptions to the U.S.'s umbrella beneficial ownership reporting regime, including by covering purchasers that are nonprofits, pooled investment vehicles that are not registered with the Securities and Exchange Commission (e.g., hedge funds and private equity funds), as well as large companies (those with 20+ employees and over $5 million in gross receipts).

4. **Unfortunately, the Draft Rule would only apply to residential—and not *commercial*—real estate transfers, leaving open a major channel for dirty money to infiltrate the United States.**

As far back as 2006, FinCEN identified money laundering risks posed by the U.S. commercial real estate sector, concluding then that "Since 2003, the trend line in suspicious activity reporting associated with potential commercial real estate-related money laundering has risen steeply." This concern has been echoed and elevated in subsequent reports, including Global Financial Integrity's *Acres of Money Laundering* report in 2021 and more-recent, related alerts from FinCEN itself.

Unfortunately, while the Draft Rule would cover properties that *include* a commercial element (e.g., the owners of a Mom & Pop store residing above their shop), it is otherwise functionally silent on the issue.

While Treasury has stated elsewhere that it is "considering next steps" for addressing illicit finance risks posed by the U.S.'s commercial real estate sector, Treasury's cabining of the Draft Rule to residential real estate leaves the United States' potential AML framework at odds with nearly 20 other OECD countries—all of which apply their AML rules to both residential and commercial real estate, without distinction—as concluded in a recent TI US report.

While commercial transactions are often more complex, and involve multiple buyers or buying groups, as we wrote in our February 2021 comment, “it is precisely the complicated nature, and lack of transparency, of these purchases that make these transactions higher risk and thus worthy of being covered[.]” To adequately protect U.S. real estate from being poisoned by the proceeds of corruption and other illicit financing, Treasury must not only propose, but finalize, a similar rule covering commercial transfers before the end of 2024.

**For questions or comments, please contact:**
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