

FinCEN Proposes AML Compliance Obligations for Non-Financed Real Estate Transactions

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Following consideration of comments received from an Advanced Notice of Proposed Rulemaking,[1] on February 16, 2024, FinCEN issued a proposed rule (the “**Proposed Rule**”)[2] that for the first time would require non-financed residential real estate transfers involving transfers to entities, including trusts, to be reported to FinCEN in a format similar to initial reports required to be filed pursuant to the Corporate Transparency Act and implementing FinCEN regulations (the “**BOI Regulations**”).[3]

Unlike the reporting requirements of the BOI Regulations—which generally apply to financial institutions that are familiar with compliance obligations under applicable anti-money laundering (“**AML**”) reporting requirements, when adopted, the Proposed Rule would include within the scope of coverage reporting persons and entities that heretofore were exempt from AML compliance and reporting obligations (*i.e.*, and accordingly very unfamiliar with AML compliance obligations), including persons and entities that provide residential real estate settlement services for specified residential transfers that do not involve a financing component.

This Alert summarizes significant provisions of the Proposed Rule. Based upon historical experience, it is likely that few modifications will be adopted by FinCEN when the Proposed Rule is finalized. Accordingly, settlement service providers in the residential real estate market might consider familiarizing themselves with the compliance requirements of the Proposed Rule which, as described below, includes the ability to contractually delegate to another reporting person or entity required reporting and record keeping obligations.

Overview of the Proposed Rule

Despite significant evidence that non-financed real estate transfers provided a significant means to engage in money laundering, except for limited “geographic targeting orders” (“**GTOs**”),[4] for many years, FinCEN has exempted that category of transactions from comprehensive regulation under the Bank Secrecy Act and applicable FinCEN

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Regulations.^[5]

The Proposed Rule would require that certain persons involved in residential real estate closings and settlements file a so-called streamlined version of a Suspicious Activity Report (“**SAR**”), referred to in the Proposed Rule as a “Real Estate Report” and to maintain compliance records for a five-year period. The persons subject to these reporting and recordkeeping requirements are defined in the Proposed Rule as “reporting persons,” and the obligation to file a report would be determined through a “cascading” or descending order of priority approach based on the function performed by the person in the subject real estate closing and settlement process.

Although FinCEN has stated that a Real Estate Report is a streamlined version of a SAR, as discussed below, the proposed information that must be included in a Real Estate Report is anything except streamlined, and includes detailed information about: (a) the transaction; (b) the transferor; (c) the transferee; (d) the reporting person or entity; (e) the consideration paid; and (f) beneficial ownership information of the parties to the transaction. Importantly, because only one filing relating to a covered transaction would be required for a Real Estate Report, as compared to the filing of a traditional SAR, which is an ongoing obligation when a money laundering or other illegal activity is identified, covered persons subject to the reporting requirement under the Proposed Rule would not need to maintain the more detailed AML compliance programs otherwise required of financial institutions under the BSA.^[6]

What follows is a summary of significant provisions of the Proposed Rule, including: (a) real estate transactions covered by the Proposed Rule; (b) transferees holding ownership interests covered by the Proposed Rule; (c) reporting persons; (d) exemptions; (e) information required to be included in a Real Estate Report; (f) record keeping requirements; and (g) the effective date of the Proposed Rule.

Each will be addressed separately below.

Covered Real Estate Transactions

The Proposed Rule would impose reporting and recordkeeping requirements related to certain transfers of residential real property made to a transferee entity or a transferee trust (defined in the Proposed Rule as “reportable transfers”).

Unlike the targeted approach employed for FinCEN’s GTOs, the Proposed Rule is intentionally meant to broadly capture residential real property throughout the United States, including any State, the District of Columbia, the Indian lands (as that term is defined in the Indian Gaming Regulatory Act), and any territory or possession of the United States.^[7]

The term “residential real estate” includes single family houses, townhouses, condominiums, and cooperatives, as well as apartment buildings designed for one to four families.^[8] As explained in the analysis accompanying the Proposed Rule, the test to determine whether real property constitutes reportable residential real property can be

met in one of three ways: (a) the real property includes a structure designed principally for occupancy by one to four families; (b) the real property is vacant or unimproved, and is zoned, or for which a permit has been issued, for occupancy by one to four families; or (c) the real property ownership is evidenced by a share in a cooperative housing corporation.

Transferees and Ownership Interests Covered by the Proposed Rule

The keys to understand the Proposed Rule is to understand the definitions of transferee entities and transferee trusts, as well as when an entity and trust holds an “ownership interest” in residential real property being transferred.

A “transferee entity” is any person other than a transferee trust or an individual. For example, a transferee entity may be a corporation, partnership, estate, association, or limited liability company. By reference to the BOI Regulations, a transferee entity is as broad as any “Foreign Reporting Company” (as defined in the BOI Regulations)^[9] except for natural persons and trust entities.

A “transferee trust” is defined as any legal arrangement created when a person (*i.e.*, a settlor or grantor) places assets under the control of a trustee for the benefit of one or more persons or entities (*i.e.*, a beneficiary) or for a specified purpose, as well as any legal arrangement similar in structure or function.^[10] Unlike the BOI Regulations in which only statutory trusts are covered for reporting purposes, a transferee trust is any trust entity formed under statutory or common law, and includes trust structures organized within the domestic United States or in a foreign jurisdiction.^[11]

Finally, a Real Property Report must be filed if an “ownership interest” is acquired in residential real property by a transferee entity or a transferee trust. An ownership interest in covered residential real property constitutes rights to the real property that is evidenced through a deed or, for an interest in a cooperative housing corporation, through stock, shares, membership, a certificate, or other contractual agreement evidencing ownership.

Covered Reporting Persons

Because most bank and non-bank lenders may not be involved in a covered non-financed real property transfer,^[12] the Proposed Rule creates a descending priority of settlement service participants that would be responsible for filing a Real Property Report. In descending order of priority, those persons and entities are:

- Real estate professionals providing certain settlement services in the settlement process—and specifically the person listed as the closing or settlement agent for a settlement;
- If no person or entity prepares a closing or settlement statement, the person that files 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—most typically this will be a title insurance company or a person or entity that issues a similar form of title insurance or guaranty;

- The person that disburses the greatest amount of funds in connection with the reportable transfer, which in many cases would be an escrow company or an attorney holding funds in a client trust account;
- The person that prepares an evaluation of the title status; and
- The person who prepares the deed, which in many jurisdictions would be prepared either by an attorney or a title company.

It should be noted that the cascade of persons and entities constitutes a somewhat mishmash of functionality that may differ significantly from state to state. For example, in many state jurisdictions attorneys play a significant role in real estate closings, whereas in other states attorneys are rarely involved.

Importantly, the Proposed Rule allows reporting persons to contract among settlement providers the obligation to file a Real Estate Report. This would permit, for example, a title insurance company to prepare and file a Real Estate Report even though the title insurance company would have a lower priority in the cascade than another person or entity.

Exemptions

In a manner similar to the exemptions provided for in the BOI Regulations, the Proposed Rule provides numerous exemptions for entities whose ownership and control information is widely available. The exemptions include:

- Securities reporting issuers;
- Governmental authorities;
- Banks;
- Credit unions;
- Depository institution holding companies;
- Money service businesses;
- Securities brokers or dealers;
- Securities exchanges or clearing agencies;
- Other Exchange Act registered entities;
- Insurance companies;
- State-licensed insurance producers;
- Commodity Exchange Act registered entities;
- Public utilities;
- Financial market utilities;
- SEC-registered investment companies; and
- Subsidiaries of an exempted entity whose ownership interests are controlled or wholly owned, directly or indirectly, by an exempted entity.

It is important to note that, while the list of exempted entities substantially mirrors the exempted entities set forth in the BOI Regulations,^[13] a notable omission is that “large operating companies”^[14] that are exempt under the BOI Regulations are not exempted from coverage under the Proposed Rule. This is based upon FinCEN’s view that large companies (which are not, for example, SEC- registered companies) may be the source of potential money laundering by transferring covered real property under their control.

Information to be Included in a Real Estate Report

Although the majority of the analysis accompanying the Proposed Rule focuses on gathering and reporting information regarding a transferee entity or transferee trust, the information required to be included in a Real Estate Report for a reportable transfer is much broader and significantly more detailed, and includes, among other things, information regarding: (a) the real property, including any compensation paid by the parties; (b) the reporting person; (c) the transferor; (d) the transferee entity or transferee trust; (e) the individual signing a transfer document; and (f) the beneficial ownership of the transferee.

For purposes of brevity, the following is a summary of several information items that must be included in a Real Estate Report; depending upon the status and category of the individual or entity:

- The full legal name of the individual or entity;
- The status of the person or entity (e.g., reporting person, transferor, transferee, etc.);
- Information regarding the transfer and transaction, including property location, and certain economic terms of the transaction;
- The street address of the reporting person's residence or principal place of business in the United States;
- Beneficial ownership information generally determined pursuant to the BOI Regulations;^[15]
- A unique identification number, such as a TIN or acceptable domestic or foreign substitute;
- In the case of a trust, information regarding trust organization and status; and
- In the case of a party signing a transfer document, the capacity of the individual or entity executing the transfer.

As contemplated by the Proposed Rule, in order to prepare a Real Estate Report, a reporting person will be required to address each of the reporting information categories identified above (e.g., the transferor and the transferee) and obtain required data from each of the persons or entities. For example, a non-exempt company may be a transferor, with the transferee being another corporation. The transferee corporation, in turn, would be required to identify its beneficial owners for inclusion in the Real Estate Report. Similarly, in the case of a transferee trust, the trust document must be analyzed to identify who, besides the trustee, is a beneficial owner of the trust.

In short, depending upon the facts underlying the reportable transfer, the data gathering may be complicated. Further, unlike the BOI Regulations that require beneficial owners of a reporting company to cooperate with the reporting company and to provide required information, the Proposed Rule is silent on this issue, which might permit a beneficial owner the flexibility to refuse to cooperate with a reporting person under the Proposed Rule.

For reporting persons not accustomed to gathering sensitive and potentially complicated information, the Proposed Rule provides some useful guidance. Specifically, the Proposed Rule will allow a reporting person to collect information from a transferee or a

person representing the transferee, provided the transferee or their representative certifies in writing, to the best of their knowledge, the accuracy of the information. In addition, as noted above, persons falling within the cascade list of reportable persons will be able to contract with other persons or entities falling within the cascade in order to transfer to another person or entity that regulatory obligation.

Recordkeeping

A reporting person will be required to maintain a copy of a filed Real Estate Report, a certification obtained from a transferee, and a designation (i.e. delegation) agreement for five years.

Effective Date

When finalized, the Proposed Rule would become effective one year following publication in the *Federal Register*.

Initial Observations

We offer the following initial observations.

First, as described above, the disclosure scheme contemplated by the Proposed Rule is potentially complicated and detailed in the information that it will require. Many of the settlement service providers that are in the cascade of reporting persons have historically fallen outside of AML compliance requirements, and the preparation of a Real Estate Report, including training of personnel, will likely fall to that of outside vendors.

Second, the description of the real estate settlement process contained in the Proposed Rule is perhaps more reflective of a summary of the real estate settlement industry created by a layperson than reflective of the actual process of real estate closings on a state-by-state basis. Reporting persons will be required to extrapolate terminology used in the Proposed Rule to actual local nomenclature and practice. For example, in many states the central role played by attorneys in a real estate settlement may result in lawyers holding the highest priority in the cascade of reporting persons under the Proposed Rule.

[1] 86 *Fed. Reg.* 69589 (Dec. 8, 2021).

[2] [2024-02565.pdf \(govinfo.gov\)](#).

[3] 31 C.F.R. § 1010.380 *et seq.*

[4] [GTO Order Phase 17 \(fincen.gov\)](#).

[5] 67 *Fed Reg.* 21111 (Apr. 29, 2002).

[6] The BSA requires each covered financial institution to establish an AML/CFT program, which must include, at a minimum: (a) the development of internal policies, procedures, and controls; (b) the designation of a compliance officer; (c) an ongoing employee training program; and (d) an independent audit function to test programs. In addition, for covered financial institutions required to have an AML/CFT program, that category of financial institution is required to file SARs when suspicious activity is identified. See, 31 U.S.C 5312(a)(2); 31 C.F.R. § 1010.200 *et seq.*

[7] 31 CFR §1010.100(hhh).

[8] Real property would be covered in the case of a mixed-use development, such as a building with ground floor commercial space, and apartments or condominium units on higher floors.

[9] 31 C.F.R. § 380(c)(1)(ii).

[10] The impact of this broad definition is that typical family estate planning through the use of a family trust would require the filing of a Real Estate Report.

[11] According to the Proposed Rule, the titling of a transfer is not material, meaning that a transfer to a trust is covered whether the subject real property is titled in the name of a trust itself or in the name of the trustee in the capacity as the trustee of the trust.

[12] While bank and non-bank lenders would not be providing financing, those entities might be reporting persons if settlement services were provided (other than financing), such as escrow services provided directly or through an affiliated company.

[13] 31 C.F.R. § 380(c)(2).

[14] 31 C.F.R. § 380(c)(2)(xxi).

[15] 31 C.F.R. § 380(d).