

ALERTS

FinCEN Issues Proposed Rule to Implement AML Reporting Requirements for Real Estate Sector

May 3, 2024

On Feb. 16, 2024, the Financial Crimes Enforcement Network (“FinCEN”), a bureau of the United States Department of the Treasury (“Treasury”), issued a notice of proposed rulemaking (“Proposed Rule”)[1] continuing the process of implementing regulations to combat illicit finance risks posed by abuse by some in the real estate market. The Proposed Rule would require certain persons involved in residential real estate closings and settlements to submit reports (“Real Estate Reports”) and keep accurate records of certain non-financed transfers of US residential real property. The reasoning behind the Proposed Rule is explained extensively in FinCEN’s December 2021 Anti-Money Laundering Regulations for Real Estate Transactions Advanced Notice of Proposed Rulemaking, which discusses “the opacity of shell companies or other legal entity structures to mask true beneficial ownership of a property and their involvement in real estate transactions.”[2]

Although FinCEN has statutory authority to extend anti-money laundering (“AML”) requirements to “persons involved in real estate closings and settlements”[3] as such category of persons are included in the statutory definition of financial institution under the Bank Secrecy Act (“BSA”), FinCEN has not yet implemented comprehensive regulations applying the BSA to such category of persons. Rather, FinCEN has addressed money laundering and terrorist financing risks presented through real estate activity through the issuance of a series of geographic targeting orders to the real estate sector that were limited in duration and geographic scope.

The Proposed Rule would impose new reporting requirements in connection with certain residential real estate transfers where the transferee of the property is a legal entity (“Transferee Entity”) or trust (“Transferee Trust”). Transfers made directly to an individual would not be covered by this rule. The Real Estate Report must include, among other things, information concerning the property being transferred, and identifying information on the Transferee Entity or Transferee Trust and its beneficial owners, the transferor, and the person filing the Real Estate Report (“Reporting Person”).

The reporting obligations will take effect one year after the promulgation of final regulations by FinCEN.[4]

What Transfers are Reportable?

Under the Proposed Rule, Real Estate Reports are required only where an ownership interest in residential real property is transferred to a Transferee Entity or Transferee Trust.[5]

Residential real property includes: (1) real property that includes a structure designed principally for occupancy by one to four families; (2) land that is vacant or unimproved, and that is zoned, or for which a permit has been issued, for occupancy by one to four families; or (3) a share in a cooperative housing corporation (“Reportable Property”).[6] Reportable Property only includes property located in the US, including any state, the District of Columbia, Indian lands and territorial possessions of the US.

An ownership interest is evidenced by rights to the property that are demonstrated through a deed or, for an interest in a cooperative housing corporation, through stock, shares, membership, a certificate or other contractual agreement evidencing ownership. The transfer is reportable even if one or more other transferees receive an ownership interest in the Reportable Property as part of the same transaction.

Transfers involving an extension of credit to a Transferee Entity or Transferee Trust are exempt from this reporting requirement if: (1) the credit is secured by the Reportable Property and (2) is extended by a financial institution that has an obligation to maintain an AML program and a requirement to file suspicious activity reports (“SARs”). Transfers financed by a private lender or the seller would not fall within this exemption. Also exempt are transfers that are the result of a grant, transfer or revocation of an easement; transfers that occur as a result of

the death of an owner of the residential real property; transfers that are the result of divorce or dissolution of marriage; and transfers to a bankruptcy estate. There is no obligation to file a Real Estate Report if the transfer does not involve a Reporting Person. Note that there are no exemptions based on the value of the property or the purchase price.

Key Terms

The definitions of Transferee Entity and Transferee Trust broadly include most entities or trusts obtaining an ownership interest in Reportable Property. However, there are exemptions to the definitions of Transferee Entity and Transferee Trust that cover certain highly regulated entities and trusts that are subject to BSA AML program requirement or to other significant regulatory reporting requirements.

Definition of Transferee Entity. The Proposed Rule defines Transferee Entity as “any person other than a transferee trust or an individual”[7] that is not otherwise exempt. Many, although not all, of the entities exempt from reporting under the Corporate Transparency Act (“CTA”)[8] are also excluded from the definition of Transferee Entity. Those exempt entities include: registered investment companies, securities reporting issuers and certain banks, credit unions, depository institution holding companies, money service businesses, brokers or dealers in securities, securities exchange or clearing agencies, other Exchange Act registered entities, insurance companies, state-licensed insurance producers, Commodity Exchange Act registered entities, public utilities, financial market utilities and US governmental authorities, as well as any legal entity whose ownership interests are controlled or wholly owned, directly or indirectly, by any of the above entities.

Pooled investment vehicles (“PIVs”) that are investment companies and are registered with the SEC would be exempt from the definition of a Transferee Entity. However, PIVs that are not registered with the SEC may be Transferee Entities.[9] FinCEN reasoned that unregistered PIVs are not subject to comprehensive AML regulations and are therefore vulnerable to abuse by illicit actors.

Notably, large operating companies as defined under the CTA are not exempt from the definition of Transferee Entity unless they fall under other exemption categories. Non-profit organizations are also not exempt from the definition of Transferee Entity.

Definition of Transferee Trust. The Proposed Rule defines Transferee Trust as “any legal arrangement created when a person (generally known as a settlor or grantor) places assets under the control of a trustee for the benefit of one or more persons (each generally known as a beneficiary) or for a specified purpose, as well as any legal arrangement similar in structure or function to the above, whether formed under the laws of the United States or a foreign jurisdiction”[10] that is not otherwise exempt. A Transferee Trust includes trust property titled in the name of the trustee in their capacity as trustee for the Transferee Trust. Excluded from Transferee Trusts are trusts that are securities reporting issuers or trusts that have a trustee that is a securities reporting issuer.[11] Statutory trusts are also exempt from the definition of Transferee Trust but could be considered a Transferee Entity, unless subject to another exemption.

Definition of Beneficial Owner. Real Estate Reports must include beneficial owners of Transferee Entities and Transferee Trusts, as beneficial owners are defined in the CTA.

Consistent with the CTA, a beneficial owner of a Transferee Entity is “any individual who, directly or indirectly, either exercises substantial control over the transferee entity or owns or controls at least 25 percent of the ownership interests of the transferee entity.”[12] As the owners or directors of tax-exempt organizations do not hold a direct ownership stake in the organization, the reportable beneficial owners would be limited only to the individuals who exercise substantial control. Only those beneficial owners of the Transferee Entity on the date of closing must be reported.

A beneficial owner of a Transferee Trust is any individual who, at the time of the real estate transfer to the Transferee Trust: (1) is a trustee; (2) otherwise has authority to dispose of Transferee Trust assets, such as may be the case with a trust protector; (3) is a beneficiary who is the sole permissible recipient of income and principal from the Transferee Trust or who has the right to demand a distribution of, or to withdraw, substantially all of the assets of the Transferee Trust; (4) is a grantor or settlor of a revocable Transferee Trust; or (5) is the beneficial owner of a legal entity or trust that holds one of the positions described in (1)-(4), taking into account the exemptions that apply to Transferee Entities and Transferee Trusts.

Who is Responsible for Reporting?

FinCEN proposes a cascade approach to reporting obligations in the Proposed Rule. They identify five levels of persons who are responsible for filing the Real Estate Report as set forth herein and explain that: “a real estate professional would be a reporting person required to file a report and keep records for a given transfer if the person performs a function described in the cascade and no other person performs a function described higher in the cascade.”[13] For example, “if no person is involved in the transfer as described in the first tier of potential Reporting Persons, the reporting obligation would fall to the person involved in the transfer as described in the second tier of potential reporting persons, if any, and so on.”[14] The categories are based on the functions performed in a closing or settlement. That means that a Reporting Person could be a buyer representative, real estate agent, attorney or any other person.

The cascade order is, as follows:

- *First, Real estate professionals providing certain settlement services in the settlement process.* This is the person listed as the closing or settlement agent on a settlement or closing statement. If there is no one listed, the reporting obligation falls on the person that prepared the closing or settlement statement.
- *Next, the person that underwrites an owner's title insurance policy for the transferee.*
- *Third, the person that disburses the greatest amount of funds in connection with the real estate transfer.* Disbursement may be in any form, including from an escrow account, trust account or lawyer's trust account. This includes persons disbursing funds through third-party accounts and excludes direct transfers from transferees as well as disbursements coming directly from banks.
- *Fourth, the person that prepares an evaluation of the title status.* This takes the form of a title check that is usually performed by the title insurance company.
- *Finally, the person who prepares the deed.*

There is no obligation of persons in the cascade to verify that any other potential Reporting Person has filed a Real Estate Report. Although the cascade is the default way to determine the Reporting Person, those in the cascade can enter into a written agreement to designate another person in the cascade as the Reporting Person.

Where the Reporting Person is an employee, agent or partner acting within the scope of such individual's employment, agency or partnership, then the individual's employer, principal or partnership is deemed to be the Reporting Person. Accordingly, the employer, principal or partnership would have the responsibility to file a Real Estate Report with FinCEN.

Certification

The Reporting Person may collect the information required for a Real Estate Report from a Transferee Entity or Transferee Trust or a representative of the Transferee Entity or Transferee Trust, so long as that person certifies that the information is correct to the best of his or her knowledge. The Reporting Person may rely upon that information, unless the Reporting Person knows, suspects or has reason to suspect the information is inaccurate or incomplete.

Record Keeping

All Reporting Persons must keep a copy of any Real Estate Report filed with FinCEN with respect to the transaction and any certification for five years from the date of filing. Each party to an agreement designating a Reporting Person (not just the Reporting Person) must retain a copy of the agreement for five years from the date of signing.

What Information Must be Reported?

The following information must be included on a Real Estate Report for each Transferee Entity:

- *Transferee Entity.* (1) name; (2) trade name or "doing business as" name; (3) street address of principal place of business, and, if not in the US, the street address of the primary location in the US where the Transferee Entity conducts business; and (4) unique identifying number, such as a TIN.
- *Beneficial owners of each Transferee Entity.* (1) name; (2) date of birth; (3) residential street address; (4) citizenship; and (5) unique identifying number, such as a TIN.
- *Signing individual(s)[15] of each Transferee Entity.* (1) name; (2) date of birth; (3) residential street address; (4) unique identifying number, such as a TIN; (5) description of the capacity in which the individual is

authorized to act as the signing individual; and (6) if the signing individual is acting in that capacity as an employee, agent, or partner, the name of the individual's employer, principal, or partnership.

The following information must be included on a Real Estate Report for each Transferee Trust:

- *Transferee Trust:* (1) name; (2) date the trust instrument was executed; (3) street address that is the trust's place of administration; (4) unique identifying number, such as a TIN; and (5) whether the trust is revocable.
- *Each trustee that is a legal entity:* (1) name; (2) trade name or "doing business as" name; (3) street address of principal place of business, and, if not in the US, the street address of the primary location in the US where the transferee trustee conducts business; (4) name and business address of the trust officer assigned to the trust; and (5) unique identifying number, such as a TIN.[16]
- *Beneficial owners of each Transferee Trust:* same as beneficial owners for Transferee Entities.
- *Signing individual(s) of each Transferee Entity:* same as signing individuals for Transferee Entities.

The following information must be included on a Real Estate Report for each Reporting Person: (1) name; (2) principal place of business; and (3) category of Reporting Person in the cascade.

The following information must be included on a Real Estate Report for each transferor:

- *Individual transferor:* (1) name; (2) date of birth; (3) residential street address; and (4) unique identifying number, such as a TIN
- *Transferor entity:* (1) name; (2) trade name or "doing business as" name; (3) street address of principal place of business, and, if not in the US, the street address of the primary location in the US where the transferor entity conducts business; and (4) unique identifying number, such as a TIN.
- *Transferor trust:* (1) name; (2) date the trust instrument was executed; (3) unique identifying number, such as a TIN; (4) for each individual that is a trustee, name, address and unique identifying number, such as a TIN; and (5) for each legal entity trustee: name, trade name or "doing

business as” name, street address of principal place of business, and, if not in the US, the street address of the primary location in the US where the transferor trustee conducts business and unique identifying number, such as a TIN.

The following information must be included on a Real Estate Report for each Reportable Property: street address and, if applicable, the legal description, such as the section, lot and block.

The following information must be included on a Real Estate Report concerning payments made in connection with a Reportable Property: (1) total amount paid by all transferees for the property; (2) total amount paid by the Transferee Entity or Transferee Trust; (3) method of each payment made by the Transferee Entity or Transferee Trust; (4) accounts and financial institutions used for each such payment; and (5) if the payor is anyone other than the Transferee Entity or Transferee Trust, the name of the payor. Payments made from escrow or trust accounts held by the Reporting Person are exempt.

The Real Estate Report must also include whether the real estate transfer involved a credit extension by a person that is not a financial institution with an obligation to maintain an AML program and an obligation to file SARs.

Report Timing

A Reporting Person must file a Real Estate Report with FinCEN no later than 30 days after the day on which the Transferee Entity or Transferee Trust receives the ownership interest in the Reportable Property. The Real Estate Reports are essentially simplified versions of SARs.^[17] Unlike reports required under the CTA, the Proposed Rule would not require Reporting Persons to report changes to beneficial ownership of a Transferee Entity or Transferee Trust.

Confidentiality

Real Estate Reports, like SARs, will be held in a secure FinCEN database and will not be publicly accessible. Unlike SARs, the Proposed Rule proposes to exempt Reporting Persons and Federal, State, local or Tribal government authorities from the confidentiality provision in 31 U.S.C. § 5318(g)(2) that prohibit disclosing the transaction has been reported to

any person involved in the transaction. The Reports are not considered confidential from the other parties to the transaction.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] Notice of Proposed Rulemaking, Anti-Money Laundering Regulations for Residential Real Estate Transfers, 89 Fed. Reg. 12,424 (Feb. 16, 2024), available here (hereinafter, “Proposed Rule”).

[2] Advanced Notice of Proposed Rulemaking, Anti-Money Laundering Regulations for Real Estate Transactions, 86 Fed. Reg. 69,589, 69,591 (Dec. 8, 2021), available here (hereinafter, “ANPRM”). For more information on the ANPRM, please see our prior *Alert* “FinCEN Commences Rulemaking Process to Implement AML Reporting Requirements for Real Estate Sector,” available here.

[3] 31 U.S.C. § 5312(a)(2)(U).

[4] Questions and comments on the Proposed Rule were due April 16, 2024

[5] The transfer is reportable even if one or more other transferees receive an ownership interest in the same property as part of the same transaction.

[6] Properties with a commercial element may be Reportable Property if they meet any of three prongs in the definition of Reportable Property, such as a single-family residence that is located above a commercial enterprise.

[7] Proposed Rule at § 1031.320(j)(10).

[8] The CTA was enacted in January 2021 as part of the National Defense Authorization Act for Fiscal Year 2021 (“NDAA”) (CTA §§ 6401–03), available here.

[9] See Proposed Rule, 89 Fed. Reg. at 12,433 (“The difference between registered and unregistered PIVs turns in part on whether the PIV is or is not excluded from registration requirements as an investment company

under the Investment Company Act of 1940. PIVs that meet these exclusion requirements and are therefore not registered with the SEC, do not have disclosure and reporting requirements that govern similar but public PIVs, such as mutual funds or exchange-traded funds.”).

[10] Proposed Rule at § 1031.320(j)(11).

[11] Proposed Rule, 89 Fed. Reg. at 12,434

[12] 31 CFR § 1010.380(d). For more information on the beneficial owners under the CTA and beneficial ownership information reporting obligation please see our prior *Alerts*: (1) “FinCEN Issues Final Rule Requiring Reporting of Beneficial Ownership Information,” available here; (2) “The Corporate Transparency Act: Key Considerations for Compliance With the Beneficial Ownership Reporting Rule,” available here and (3) “The Corporate Transparency Act: The Private Funds Guide to Compliance With the Beneficial Ownership Reporting Rule,” available here.

[13] Proposed Rule, 89 Fed. Reg. at 12,437.

[14] *Id.*

[15] Signing individuals do not include any individual who signed documents as part of their employment with a financial institution that has an obligation to maintain an AML program and an obligation to file SARs.

[16] Each trustee that is an individual is considered a beneficial owner.

[17] While the Proposed Rule does not include a proposed form for filing Real Estate Reports, the Proposed Rule requests comments on such a form. *See e.g.*, Proposed Rule, 89 Fed. Reg. at 12,443, 12,464.

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