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BackSpace

The dirty-money dragnet is likely to expand

By Bill Conroy

As the U.S. housing market continues to improve and deal volume in hot markets expands, the opportunities for money-laundering schemes to take root tend to multiply. That prospect also means the regulatory reach of law enforcement agencies like the Treasury Department's Financial Crimes Enforcement Network (FinCEN) is likely to continue to expand across the mortgage and real estate industries.

The regulatory effort to stem money laundering could possibly even be extended in the near future, based on existing law, to professionals involved in real estate closings and settlements, such as Realtors, closing attorneys, appraisers and escrow officers. They have been so far relatively untouched by such mandates, compared to banks, credit unions and even mortgage lenders.

"After 911 and the adoption of the USA Patriot Act, the anti-money laundering (AML) requirements were spread very broadly in the financial sector, to include all kinds of companies you don't think of as financial institutions, but have some connection to a financial transaction, including real estate settlement agents," says Robert Rowe, vice president and associate chief counsel of regulatory compliance at the American Bankers Association. "Treasury looked at it, however, and said this is a major task [corralling all of these players], so we will take it in pieces, and they have been rolling out rules bit by bit. For a long time, everyone assumed that the real estate sector was very safe."

That is changing, however, as FinCEN gathers more data and gains a better understanding of where the weak links are in the system. This past January, for example, FinCEN announced that U.S. title companies were being enlisted in the AML effort under temporary rules, called geographic targeting orders (GTOs), that require them "to identify the natural persons [or beneficial owners] behind companies used to pay 'all cash' for high-end residential real estate" in Manhattan and Miami.

"FinCEN is concerned that all-cash purchases — i.e., those without bank financing — may be conducted by individuals attempting to hide their assets and identity by purchasing residential properties through limited liability companies or other opaque structures," a FinCen press release states.

This past July, FinCen extended the time frame of the GTOs targeting Manhattan and Miami for another 180 days beyond the original Aug. 27, 2016, expiration date and also expanded the geographic coverage by adding more communities — including all five New York City boroughs as well as Los Angeles, San Francisco, San Diego and San Antonio. The GTO effort was extended and expanded, in part, because FinCEN was uncovering a lot of indicators of money-laundering activity as a result of enlisting title companies in the enforcement effort.

"So far, over a quarter of transactions covered by the January 2016 GTOS [targeting Manhattan and Miami] involve a beneficial owner or purchaser representative [associated with a shell company] that is also the subject of a suspicious activity report," FinCEN spokesman Stephen Hudak says. "In other words, a significant portion of transactions covered by the January 2016 GTOs have identified independent indicia of possible criminal activity associated with the beneficial owners. The suspicious activity included, for example, a beneficial owner that engaged in $16 million in suspicious cash-withdrawal activity; a beneficial owner possibly involved in dealing counterfeit checks; and a beneficial owner connected to a network of shell companies that received about $7 million in suspicious wire transfers from businesses in South America."

Hudak says he can't speculate on FinCEN's plans for adding more markets or industry players to the AML-enforcement push, but he did say the information being collected through the GTOs will be used to "inform our future decision" and "extensions are possible."

Since 2012, nonbank residential mortgage lenders have been subject to regulations that require them to file suspicious activity reports and to develop formal AML programs for their business operations. This past May, Treasury rolled out the Customer Due Diligence Final Rule, which requires "financial institutions" within two years to begin collecting and verifying beneficial ownership information for shell companies that open accounts. Hudak says those new rules "initially" apply only to "banks, credit unions and securities brokers."

In addition, FinCEN is pushing Congress to pass legislation that would require companies formed in the U.S. to report beneficial-ownership information so that it can be made available to law enforcement.

"FinCEN appears to be in fact-gathering mode in order to create an informed approach to regulating this industry," says BuckleySandler LLP Counsel Amy Davine Kim, whose legal expertise includes a focus on AML regulations. "In 2012 in its final rule implementing AML program requirements on residential mortgage lenders, FinCEN noted that … they will consider whether to expand the definition of loan or finance company … which could potentially include real estate agents and brokers, closing attorneys and agents, escrow companies, or others."

National Association of Realtors (NAR) President Tom Salamone, in a prepared statement provided to Scotsman Guide, says real estate agents already are familiar with the indicators of money laundering and can identify and do report suspicious activity on a voluntary basis to protect their clients. He adds, however, that NAR opposes the addition of AML regulations targeting real estate agents and brokers because they would be "unnecessary and burdensome, given the existing regulations that already apply to U.S. financial institutions."

Still, Kim says FinCEN continues to see money-laundering risks in the industry that need addressing, as evidenced by the recent GTOs, and it appears to be "escalating steps to tackle them." That means mortgage and real estate professionals should be prepared for further regulatory pushes designed to strengthen the AML dragnet.

"The more entities involved in the fight against money laundering at more points along the way in the financing process increases the chances that money-laundering and terrorist-finance activity will be deterred or caught," Kim says."On the other hand, increased compliance obligations means increased costs and resources, which covered [industry] players will need to effectively incorporate into their business regimen."

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