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February 18, 2022

Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183
Attention: Acting Director Himamauli "Him" Das

Re: Real Estate Transparency (RIN: 1506-AB54) (Docket Number FINCEN-2021-0007)

Dear Acting Director Das,

The Anti-Corruption Data Collective ("ACDC") appreciates the opportunity to submit comments to the Financial Crimes Enforcement Network ("FinCEN") in response to the agency's advance notice of proposed rulemaking ("ANPRM") entitled "Anti-Money Laundering Regulations for Real Estate Transactions."[1] ACDC welcomes FinCEN's readiness to transition from the temporary real estate information collection program that it began piloting in January 2016[2] to a permanent, nationwide regime promulgated under the Bank Secrecy Act ("BSA")[3] that has the potential to transform the U.S. real estate market from an opaque market to one that will be among the most transparent in the world.

ACDC is a collective of experts and advocacy organizations that makes innovative use of publicly available data to study transnational corruption flows and develop effective policy solutions. It is a project of the Fund for Constitutional Government ("FCG"), a 501(c)(3) nonprofit corporation based in Washington, DC.

ACDC recommends that FinCEN's final rule cover all real estate transactions in the United States. The agency should collect basic sales information as well as beneficial ownership information for the buyer and seller of every piece of real property in the country, both residential and commercial. FinCEN should collect this information primarily from title insurers for residential property and from escrow agents for commercial transactions. A clean, comprehensive rule will give FinCEN actionable information to combat illicit financial activity, eliminate loopholes that would invite evasion, and make compliance simple and uniform.

[1] 86 Fed. Reg. 69,589 (December 8, 2021).
[2] https://www.fincen.gov/news/news-releases/fincen-takes-aim-real-estate-secrecy-manhattan-and-miami.
[3] 12 U.S.C. § 1829b, 12 U.S.C. § 1951 et seq., and 31 U.S.C. § 5311 et seq.

Policy Objectives

The goals of a permanent regulatory framework to bring transparency to the opaque U.S. real estate market should be to:

1) Make U.S. real estate less appealing as a destination for corruption proceeds and deter corrupt actors from purchasing real estate or profiting from real estate investments.
2) Provide actionable lead information to law enforcement agencies conducting criminal investigations and deter criminals from purchasing real estate or profiting from real estate investments.
3) Enhance national security by making the government aware of strategic acquisitions of real estate by foreign actors, including transactions subject to review by the Committee on Foreign Investment in the United States under 31 CFR Part 802.
4) Mitigate current non-compliance with existing standards, such as Section 352 of the USA PATRIOT Act and Financial Action Task Force (FATF) Recommendation 12.
5) Improve the government's understanding of real estate ownership and investment trends and the policy implications of those aggregate data.

ACDC urges FinCEN to conceive of the challenge posed by the opacity of real estate and the policy objectives before it broadly, as opposed to the restrictive framing presented in the ANPRM. FinCEN states in the Background section of the ANPRM: "The goal of this rulemaking process is to implement an effective system to collect and permit authorized uses of information concerning potential money laundering associated with non-financed transactions in the United States real estate market." That was a reasonable goal of the pilot program, which began with the issuance of geographic targeting orders ("GTO"s)[4] in January 2016. The pilot program was designed to study the problem of real estate opacity and devise potential transparency solutions at the time of its creation. Six years later, with much experience from the GTO program under its belt – and over two decades since Congress called upon the Treasury Department to address the illicit finance risks posed by real estate with the passage of the USA PATRIOT Act[5] – FinCEN should address real estate opacity in a comprehensive manner. It is unnecessary and unwise to limit the purpose of a real estate transparency regime to stopping "money laundering." Nor would that be in keeping with Congressional intent.

Since the advent of the GTO pilot program, Congress has expanded FinCEN's mission and made its national security purpose even more explicit and prominent. FinCEN's role clearly goes beyond countering money laundering, terrorism, or other criminal activity, although these efforts remain at its core. Section 6102 of the Anti-Money Laundering Act of 2020 ("AMLA")[6] expresses the sense of Congress that "the mission of FinCEN should be to continue to safeguard the financial system from illicit activity, counter money laundering and the financing of terrorism, and promote national security through strategic use of financial authorities and the collection, analysis, and dissemination of financial intelligence." Section 6102 also amends the BSA to make clear that information collection

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[4] A GTO is an order issued by FinCEN imposing temporary reporting requirements on a financial institution or nonfinancial trade or business issued under 31 U.S.C. § 5326(a).

[5] Section 352 of the USA PATRIOT Act (Public Law 107-56, October 26, 2001) required FinCEN to promulgate anti-money laundering program obligations for persons involved in real estate closings and settlements, which are financial institutions under the BSA (see 31 U.S.C. § 5312(a)(2)(U)). As noted in the ANPRM, FinCEN issued a temporary, six-month real estate exemption under Section 352 in early 2002. The obligations set forth under Section 352 are potentially far more extensive than the limited reporting regime contemplated in this comment.

[6] AMLA is contained in Division F of the National Defense Authorization Act for Fiscal Year 2021 ("2021 NDAA").

and reporting under that statute are authorized in order to combat "other forms of illicit activity" in addition to "money laundering."

These expansions to counter illicit finance and protect national security under the AMLA build on the longstanding purpose of the BSA, which is set forth in Section 5311 of that law: "It is the purpose of this subchapter [...] to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." The BSA has always been about more than just countering "money laundering" in the narrow sense of stopping financial transactions involving a specified unlawful activity, or, to use the popular terminology, interrupting the process of "placement, layering, and integration."[7]

A focus on money laundering alone also runs counter to President Joe Biden's effort to lead a united effort of democracies to stymie transnational corruption. The "United States Strategy on Countering Corruption,"[8] published by the White House in December 2021, conceives of the problem of real estate opacity in expansive terms. President Biden has described the fight against corruption as a "core national security interest." The strategy calls for the Treasury Department to "issue regulations that will include reporting requirements for those with valuable information regarding real estate transactions" as a means of countering corruption. The White House strategy further notes that, in addition to serving as a potential magnet for corruption proceeds, real estate opacity "imposes tangible costs on average Americans in the form of artificially inflated real estate prices."

Reporting Structure

Covered Transactions

The final rule should cover every transfer of ownership of real estate in the United States, with or without monetary consideration, including the transfer of a fractional share. A covered transaction should be triggered by any change in title to the property. There should be no dollar value threshold or financing carve-out, no geographic constraints, and no limitation to residential property. The final rule should introduce a new, dedicated electronic form that will capture the following information within thirty days of the transaction:

1) The name and identifying information of the buyer and seller, including natural persons.[9]
2) If either of the above is a legal entity, the beneficial owners of that entity; if either of the above is a trust, the trustees or managers, settlors or grantors, and beneficiaries of that trust.
3) Basic information concerning the transaction, including sales price, property address, property size, property type, source of funds, form of payment, a brief description of the property and other information on the transaction routinely collected during residential real estate transactions.

[7] Money laundering is criminalized at the federal level in 18 U.S.C. §§ 1956 and 1957.
[8] https://www.whitehouse.gov/wp-content/uploads/2021/12/United-States-Strategy-on-Countering-Corruption.pdf.
[9] As the ANPRM recognizes, it is important to capture the identities of natural persons, among other reasons, to identify possible straw buyers. It is important to capture the identities and beneficial ownership of sellers so as not to allow illicit actors to be "grandfathered in." Absent seller reporting, illicit actors who are already owners of U.S. real estate may be able to continue to sell and profit from their investments without scrutiny.

> As a matter of industry practice both during a potential residential purchase or lease agreement, it is routine practice within the industry to verify the three listed categories of information using documentary evidence. Any proposed rule should necessarily include verification of any information reported.

Covered Businesses

For residential property transactions, FinCEN should impose the primary information collection and reporting obligation on title insurance companies. Title insurance companies proved cooperative partners during the pilot program. The American Land Title Association, the title insurance industry group, has played a constructive role throughout the pilot program, publishing helpful guidance to encourage effective compliance. Title insurers may have been selected by FinCEN as subjects of the GTOs because they are a standard part of the residential purchase process and because there are relatively few of them, making the service of GTOs upon each company relatively straightforward. Nonetheless, there are limitations to this approach that should be considered in crafting a final rule. First, title insurance is not standard in every state; it is uncommon in Iowa, for example. Second, sole reliance on title insurance companies could inadvertently induce illicit actors to forego title insurance in order to avoid reporting requirements.[10] Therefore, the final rule should make escrow agents responsible for information collection and reporting in the event that a residential transactional does not use title insurance.

For most residential transactions, escrow agents would be required simply to confirm that a title insurance company was involved in the closing and settlement. Only the absence of title insurance would trigger reporting by the escrow agent. As a party downstream of the primary covered party, an escrow agent would have no obligation to confirm that the upstream title insurance company had complied or to validate the accuracy of the reporting. This approach would minimize the regulatory burden on escrow agents and involve them in the residential reporting process only when necessary.

Additionally, to act as an effective backstop and plug any loopholes that may emanate from cross-border real estate transactions that do not always utilize professionals based in the U.S., it is important that any reporting cascade also includes attorneys (limiting them to their closing function) and real estate agents, when none of the other professionals listed are present in the transactions. Finally, to ensure ease of enforcement, it is recommended that FinCEN impose any such proposed requirement on professionals that are licensed or registered to do business in the U.S.

For commercial property transactions, FinCEN should impose the primary information collection obligation on escrow agents. Title insurance does not play the same role in commercial real estate as it does in residential. Commercial transactions are often large, complex, and high-value. They frequently involve institutional buyers and sellers. The parties often rely on extensive due diligence that obviates the need for reliance on a third-party title insurance provider. However, even sophisticated institutional buyers need a neutral third party to hold funds in escrow. Escrow agents already review key documents relevant to the transaction. Like title insurers, they are a natural fit for the important role of covered company. Unlike title insurance companies, though, escrow agents do

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[10] Title insurance is generally not mandatory under state laws; rather, lenders typically demand that buyers obtain it. Therefore, transparency reporting requirements relying solely on the reporting of title insurers could be avoided by foregoing title insurance, at least for non-financed residential purchases.

not have experience with reporting to FinCEN under the GTO pilot program. Therefore, early outreach to escrow agents will be necessary.

Defining Beneficial Ownership

A definition of beneficial ownership of a legal entity is already set forth in FinCEN regulations at 31 CFR §1010.230 under the Customer Due Diligence Rule (“CDD Rule”). The existing regulation defines a beneficial owner as a natural person who owns a 25% or more equity share of a legal entity or otherwise exercises control over the entity. Under the CDD Rule, financial institutions holding an account for a legal entity must identify between zero to four equity owners and at least one control person. This definition of beneficial ownership has two main weaknesses. First, it allows avoidance of equity ownership reporting when holdings are capped below 25%. In other words, if there are five equity owners holding equal numbers of shares, none will be reportable. Second, it allows account holders selectively to report only one control person even if multiple people exercising control.

FinCEN’s Notice of Proposed Rulemaking to implement Section 6403 of the Corporate Transparency Act (“CTA”)[11] and establish a centralized national register of beneficial ownership of companies formed in the United States improves on the methodology of the CDD Rule.[12] First, it defines ownership interests more broadly than equity holdings alone. Second, it expands the concept of control based on the CTA’s statutory definition of “substantial control” and proposes to capture all natural persons exercising such control, in contrast with the CDD Rule’s requirement that only one control person be identified. For these reasons, FinCEN should adopt the beneficial ownership definition for legal entities from the CTA and associated NPRM for the final real estate rule. It would also be worthwhile for FinCEN to strengthen beneficial ownership reporting across its regulations in the future, particularly with regard to the CDD Rule.

Under the CDD Rule and the CTA, many pooled investment vehicles such as hedge funds and private equity funds are excluded from beneficial ownership determination requirements. For purposes of the final real estate rule, it would be reasonable for FinCEN to require reporting of the name of a pooled investment vehicle as either the direct buyer or seller or as the reportable beneficial owner of the legal entity buyer or seller, but not to drill down to the identities of end investors within the fund to ascertain natural persons’ ultimate beneficial ownership. For commercial real estate in particular, pooled investment vehicles play an important role. However, the complexity of capturing more detailed information about pooled investment vehicles, including ultimate beneficial ownership of end investors, is a significant undertaking that should be addressed separately by FinCEN and the Securities and Exchange Commission.

Unfortunately, both the CTA and the CDD Rule fail to include many trusts as vehicles covered by beneficial ownership reporting requirements, which will hopefully be remediated in the future. Trusts are typically formed by contractual arrangement and do not necessarily register with any state authority in connection with formation, and they are a common vehicle used to hold real estate. It is therefore imperative to cover trusts under the final real estate rule. It is also critical to cover foreign legal entities in the final rule. Foreign legal entities are covered by the CDD Rule but not necessarily by the CTA (unless the foreign entity is registered to do business in the United States, which may not

[11] The CTA is itself part of AMLA and the 2021 NDAA.
[12] The NPRM at 86 Fed. Reg. 69,920 (December 8, 2021).

be the case if an entity is solely holding U.S. real property). Excluding domestic and foreign trusts or foreign legal entities from a final rule to promote transparency of real estate ownership would gravely damage its efficacy.

Residential vs. Commercial Property

The GTOs cover only residential property, but they do not define the term. However, Frequently Asked Questions published by FinCEN in April 2021 to accompany the renewal of the GTOs provide guidance on this question. They say: “For purposes of the GTOs, ‘residential real property’ means real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from one to four families.”[13] While this explanation was helpful to assist in compliance with the GTOs, the final rule should clarify the guidance and solidify the definition of residential property as distinct from commercial property, particularly given the possibility that FinCEN may decide to stagger the commencement of reporting for the two property types (see the “Sequencing” section of this comment below for discussion of a staggered or iterative approach).

The final rule should define residential real estate as real property containing between one and four dwelling units. The rule should clarify that real property is residential if people may legally dwell there, making the “design” or “original intent” of the property irrelevant. The rule should also make clear that real property will be considered residential if the physical structures on a given lot comprise four or fewer individual dwelling units. Thus, an institutional buyer of a large parcel of land made up of multiple lots, with each lot containing one single-family residence, could not claim that the purchase aggregated to a commercial transaction, with the houses together totaling more than four dwelling units. Bulk purchases of single-family residences or condominiums would be classified as residential. The purchase of a large, multi-unit rental apartment building, on the other hand, would be classified as commercial.

The GTOs were intended to study the problem of opacity in real estate and allow FinCEN to explore permanent regulatory options. The pilot program never intended to offer a permanent solution. It made sense to begin to study the issue with the most straightforward typology and the most obvious place to look for potential corruption or other illicit activity. All-cash purchases of houses or condos in major cities were a sensible place to start. It is obvious, though, that carving out commercial property from a final rule would create a powerful incentive pushing illicit activity from residential to commercial, even if illicit actors were not already active in commercial real estate. In fact, ACDC partner organization Global Financial Integrity has demonstrated that suspected corruption proceeds already flow to the commercial side in large quantities. Thirty percent of the cases profiled in its recent report, “Acres of Money Laundering: Why U.S. Real Estate is a Kleptocrat’s Dream,”[14] which FinCEN cites in the ANPRM, involved commercial property.

Vacant land should also be categorized as commercial property.

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[13] https://www.fincen.gov/sites/default/files/shared/FAQs%20on%20Real%20Estate%20GTO%20April%202021_508%20FINAL.pdf.

[14] https://gfintegrity.org/report/acres-of-money-laundering-why-u-s-real-estate-is-a-kleptocrats-dream/.

Financed vs. Non-Financed Transactions

The final rule should cover financed and non-financed transactions alike. There is an implied assumption in the ANPRM that there is minimal value in a stream of reporting from persons involved in closing and settlement of beneficial ownership and other information under a transparency program separate from the anti-money laundering ("AML") program obligations of mortgage lenders. This assumption is mistaken for several reasons.

It is true that mortgage lenders must identify the beneficial owners of legal entity customer borrowers. However, that beneficial ownership information is not generally reported to FinCEN or linked in any way to a specific reported property transaction, unless a SAR is filed. In contrast with buyer information, mortgage lenders lack access to beneficial ownership information for the seller, which this comment proposes be captured in the final rule. Moreover, mortgage lenders fall into two categories. Depository institutions such as banks and credit unions are subject to examination by a federal functional regulator. A large portion of the residential mortgage market, however, is made up of residential mortgage lenders and originators, or RMLOs, who are state-licensed and lack a federal functional regulator.[15] AML controls in this large segment of the market may be weaker than among depository institutions.

For all of these reasons, the final rule should cover financed transactions. If FinCEN nonetheless excludes financed transactions from the rule, the definition of "financing" must be kept extremely tight. The GTOs covered purchases "made without a bank loan or other similar form of external financing." This verbiage is excessively vague. Any definition of a "financed transaction" in the final rule should encompass only the purchase of real estate directly financed by a mortgage that was issued by a U.S.-based financial institution subject to the BSA and collateralized against the property being bought. A company that issues bonds to finance operations, an investment fund that takes a short-term loan to bridge limited partner capital calls, or an individual who taps a personal line of credit would be treated as engaging in a non-financed transaction. Failure to craft a tight definition of financing will inevitably sow confusion and potentially exempt the vast majority of commercial property transactions, hobbling the program at birth.

Sequencing

It is essential to cover both residential and commercial real estate. FinCEN should seize the moment to cover both during this rulemaking process. Yet it is conceivable that there may be different effective dates for residential reporting and commercial reporting. FinCEN should not delay in finalizing a rule for commercial real estate. However, if the agency believes it needs more time to ensure that it fully understands operational aspects of reporting on commercial transactions, an effective date for commercial property six to twelve months after residential reporting commences would be reasonable. FinCEN must not squander the opportunity of this moment and allow the rulemaking process to terminate without a framework for commercial property.

[15] See 77 Fed. Reg. 8,148 (February 14, 2012).

Statutory Authority

The ANPRM solicits public comment as to which portions of the BSA should form the statutory basis for the final rule, specifically whether the rule should invoke 31 U.S.C. § 5318(a)(2) or § 5318(g) and (h). Paragraph (a) authorizes FinCEN to impose collection and reporting requirements on financial institutions or nonfinancial trades or businesses. Paragraphs (g) and (h) authorize FinCEN to impose suspicious activity report (SAR) filing obligations and AML program obligations on financial institutions. In ACDC's view, this is a question best answered by Treasury and Justice Department attorneys. Either approach would provide an adequate foundation for the real estate transparency program set forth in this comment.

Persons involved in real estate closings and settlements are defined as financial institutions under the BSA at 31 U.S.C. § 5312(a)(2)(U). Title insurance companies and escrow agents are clearly persons involved in real estate closings and settlements. Program requirements imposed on financial institutions under the BSA have stood the test of time. Therefore, imposing reporting obligations on these parties as financial institutions subject to limited AML program obligations is unassailable. ACDC does not view SAR filing obligations or other traditional AML program elements – such as customer risk rating, transaction monitoring, or full customer due diligence – as absolutely vital at this time.

If for some reason FinCEN prefers not to define these parties as financial institutions, the alternate route of imposing reporting requirements on them under 31 U.S.C. § 5318(a)(2) remains available. This would be an approach with less extensive precedent, but also a defensible one.

FinCEN should use whichever authority it believes will best withstand any potential legal challenge, taking into consideration the statutory language, the case law, and the agency's own analysis.

Supervision and Enforcement

Title insurance companies and escrow agents lack a federal functional regulator to which it would be appropriate for FinCEN to delegate responsibility for examination. FinCEN must allocate sufficient resources to conduct direct examinations of high-priority covered businesses after the final rule goes into effect. The agency should also explore the possibility of working in conjunction with state regulators on joint examination teams, when title insurance and escrow companies are subject to state-level regulation and the state already conducts regular examinations for compliance with other laws and regulations.

This approach could serve as a model for other areas of supervision in which the covered businesses lack a federal function regulator, over time shifting responsibility in such cases away from the Internal Revenue Service ("IRS"). Traditionally, FinCEN delegates responsibility for examination to the IRS when a sector is not subject to examination by a federal functional regulator. The primary mission of the IRS is tax compliance, not AML compliance. It therefore makes sense to increase the involvement of FinCEN over time, weaning off reliance on the IRS.
FinCEN must also allocate sufficient staff to analyze the data produced by this program. These analysts should produce original analysis of trends and emerging threats and refer lead information to law enforcement agencies for criminal investigations and potential civil asset forfeitures. If FinCEN

discovers that it does not have enough staff to examine covered businesses and analyze the data effectively, then the Treasury Department should ask Congress for more resources.

The risk of devoting insufficient resources to examination and enforcement is manifest – non-compliance and evasion. A July 2020 report by the Government Accountability Office (GAO) studying the GTO pilot program found that FinCEN did not examine any title insurance companies for compliance with the program until over three years in and still has not examined the majority of covered companies. The examinations that did occur were somewhat superficial in nature and did not seek to determine whether companies failed to file reports required until the GTO, focusing instead on the quality of the reports that were submitted.[16]

Limited enforcement may have led to pilot program to be less effective than it could have been. As the GAO acknowledged, law enforcement authorities have found reporting under the pilot program to be useful in its investigations. But was that reporting as accurate or complete as it could have been? A new study by ACDC's David Szakonyi and Florian Hollenbach, with the Brookings Institution's Matthew Collin, finds that the pilot program likely underperformed. The paper, "The impact of ownership transparency policies on illicit purchases of US property," used U.S. residential real estate transactional data from Zillow to measure the effect of the pilot program on reportable transactions in the marketplace.[17] It found that there was no measurable effect. That is, contrary to expectations, the pilot program did not appear to decrease the volume or price point of all-cash purchases in covered counties. Nor did it cause a substitution effect in which all-cash buyers seeking anonymity increased the flow of money into non-covered counties or price points.

The purpose of the pilot program was to collect information, not to stop illicit buyers. Nonetheless, all things being equal, and given the large amount of potentially illicit or anonymity-seeking money in these markets, it would be logical and expected for some of these effects to arise as byproducts of the program. The lack of any measurable effect raises the concern that the program was not as effective as it could have been due to limited enforcement. While it collected useful information, it could have been stronger. The permanent program must be stronger.

Potential Loopholes

The real estate transparency program presented in this comment would dramatically reduce the opacity of the U.S. real estate market. Yet it would still leave two obvious loopholes for avoidance. In the first scenario, a sale or other transfer of title could occur without the involvement of a covered business. In that case, there would be no covered business with a reporting obligation.[18] In the second scenario, a buyer could purchase real estate using a foreign entity, allow the transaction to be reported to FinCEN, and then transfer ownership of the foreign entity. That ownership transfer would likely not be immediately visible to FinCEN. A similar maneuver using a U.S. entity should be caught

[16] "Anti-Money Laundering: FinCEN Should Enhance Procedures for Implementing and Evaluating Geographic Targeting Orders," Government Accountability Office, July 2020, https://www.gao.gov/assets/gao-20-546.pdf.
[17] Collin, Matthew, Florian Hollenbach, and David Szakonyi. "The Impact of Beneficial Ownership Transparency on Illicit Purchases of US Property." Anti-Corruption Data Collective Working Paper #1 (February 2022)
[18] While this typology may be a potential red flag in some circumstances, there are also legitimate scenarios. For example, a change in title within a family may occur without financial consideration or the involvement of a title insurance company, escrow agent, attorney, or realtor.

by FinCEN once the CTA beneficial ownership database is up and running. Therefore, use of a foreign entity – especially an entity formed in a jurisdiction without a public beneficial ownership register – should be considered a potential red flag in future FinCEN guidance about real estate.[19]

Conclusion

ACDC commends FinCEN's efforts to develop a strong regulatory framework transparency around the U.S. real estate market. We would be pleased to discuss this important rulemaking process with you further and invite an ongoing dialogue with civil society. Please contact ACDC at team@acdatacollective.org.

Respectfully,

David Szakonyi and Zoë Reiter, Co-founders

Anti-Corruption Data Collective
A project of the Fund for Constitutional Government

[19] There is already an existing tax disincentive posed by the withholding on a portion of the capital gain incurred by the sale of U.S. real estate by a foreign company under the Foreign Investment in Real Property Tax Act of 1980, making direct ownership by a foreign entity even more conspicuous.