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Your Patriotic Duty?: Post-9/11 Federal Compliance Requirements in Real Estate Transactions

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Posted By: William R. West & Chris A. Jenny

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In the aftermath of September 11, 2001, many U.S. industries faced an unfamiliar business landscape as new regulatory measures were quickly enacted by the federal government. These laws affected airlines, banks, and other economic sectors, including the real estate industry, and resulted in a complex web of compliance procedures and requirements. Although these measures were created to provide transparency and accountability in business transactions, the resulting confusion for the real estate industry on compliance duties and requirements has continued to this day.

It is common in real estate transaction documents to find a section of representations and warranties that throw out words and abbreviations like "anti-terrorism", "OFAC", "SDN", "FinCEN", "money-laundering", and "Patriot Act". These provisions are meant to address the post-9/11 Patriot Act and Executive Order 13224 on dealings with terrorists and money-launderers, and usually delegate the responsibility of compliance with these measures to one or both parties of the agreement.

While representations and warranties regarding non-support or association with terrorists and money-launderers may seem easy to make, it is essential to carefully analyze the wording of these provisions, and the extent that parties are covered by the representation. Commonly, these provisions may seek broad financial compliance representations as to not only the company, but to members, partners, shareholders, officers, and directors, and employees as well. For a representing party with a large organization, this can pose difficulty, as a broad representation that all members of the company are in compliance with all applicable financial laws that restrict transactions would require impossible due diligence. Furthermore, some of these clauses and representations may be ineffective, as discussed below.

Regardless, there are current regulatory compliance obligations that should be addressed by all parties to a real estate transaction, as a matter of due diligence, and to conform to current federal requirements.

The Patriot Act Lives On

In October of 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (the "Patriot Act") was signed into law. The Patriot Act responded to government officials' suspicion that the responsible terrorists had laundered money through banks in the United States and through other valuable assets, including real estate. The Patriot Act, among other transparency measures, enhanced the anti-money-laundering compliance requirements of the Bank Secrecy Act. Though the Patriot Act received renewed public derision and scrutiny after Edward Snowden's reveal of the mass surveillance of U.S. phone records in 2013, the section of the Act that addresses money laundering is still in effect to this day. The bulk surveillance of citizen phone records ended when several parts of the Act were allowed to expire on June 1, 2015, though the expired provisions were amended and renewed on June 2nd through the USA FREEDOM Act, to allow for case-by-case surveillance.

Under current law, financial institutions are required to adopt anti-money laundering procedures that include a "Know Your Customer" program, designation of an internal compliance offer, ongoing employee training, and an independent audit function to test and review the company's due diligence programs. As a result of the Patriot Act adopting the definitions of the Bank Secrecy Act, "persons involved in real estate closings and settlements" are included in the definition of "financial institutions". The law further empowers the Treasury Department to determine the extent and procedures for which it may regulate financial institutions under the act. The Secretary of the Treasury has delegated implementation authority to the Financial Crimes Enforcement Network ("FinCEN"). The penalties for violations of the Patriot Act can range from up to $1,000,000 in fines for corporations, to fines of up to $500,000 and up to 20 years' imprisonment for individuals.

Originally, all regulations regarding compliance requirements for each entity considered a "financial institution" under the act were to have been issued by 2002. Conversely, subsequent FinCEN's 2003 initial request for comments from those in the real estate industry on a notice of proposed rulemaking, no final ruling has been made on Patriot Act applicability to those broadly "involved in real estate closings and settlements." As such, there are no current requirements or suggestions for parties to a real estate transaction to make specific representations and warranties regarding compliance under the Patriot Act. (This excludes banks and mortgage lenders, who have been issued rules for compliance by FinCEN.)

Despite the lack of rulemaking in the past decade, the real estate industry's compliance under the Patriot Act has recently come back into the spotlight as an area of concern for FinCEN, which may lead to final rulemaking measures in the future. As such, it is prudent to carefully read representations and warranties provisions regarding the Patriot Act in a real estate document, and to understand the nature of the representations and any certifications regarding future compliance that a party is making.

Executive Order 13224 - Don't Do Business with Terrorists

Prior to the passing of the Patriot Act, President George W. Bush issued the Executive Order 13224, which was later codified in the Patriot Act. The Executive Order established the "Specially Designated Nationals and Blocked Persons" list, (referred to as the "SDN list"), which designates both domestic and international alleged terrorists and alleged terrorist organizations. The Executive Order mandates that no U.S. citizen or company may do business with any person or organization found on the SDN list.

While the implications of the Patriot Act for real estate transactions remain murky, requirements for compliance with the Executive Order are clear. The burden of complying with the order is placed on each party to a transaction. Commercial transactions are regulated by OFAC, and include buying, selling, and leasing property in the United States. The penalties for violation of the Executive Order can include: asset freezing and forfeiture, up to $500,000 in penalties for corporations, and up to $250,000 and 10 years' imprisonment for individuals. As such, best practices for all parties involved in a real estate transaction include:

- screening and identification at the initial stages of a potential deal or leasing transaction on who the parties involved are;
- having a process in place to access the SDN list and check the parties on the other side of a deal, including documenting the check;
- including representations and warranties that each party involved is not on the SDN list;
- including a certification that the parties involved will not appear on the SDN list (or other similar lists maintained by the government) in the future.

Recent Developments Regarding the Patriot Act in the Real Estate Industry
Recently there has been national publicity surrounding the issue of wealthy (and possibly criminal or corrupt) foreign investors who use shell companies to invest in U.S. real estate. Those concerned say that it is nearly impossible to establish the source of money behind the shell companies, as purchasers may register names through other people, or can shift ownership at any time without the property documents being affected. (See the investigative *New York Times* article.)

In March of 2015, seventeen nonprofit organizations wrote a letter to FinCEN urging them to repeal the real estate industry's exemption to the Patriot Act, and asked those in the real estate industry to screen foreign buyers for potential money-laundering risk. FinCEN agreed with the concerns expressed in the letter and acknowledged that criminal abuse of the real estate section is a real concern for the organization. Later that May, at an Anti-Money Laundering Forum, the director of FinCEN stated that during her time working in Asset Recovery at the Department of Justice, it was "apparent that the laundering of funds through real estate was a mainstay" for foreign high-level officials using corrupt proceeds. The director went on to state that "transparency in the area of beneficial ownership of corporate entities" was an "area of particular focus for FinCEN."

Consequently, FinCEN may be signaling to the industry that real estate transactions will be subject to future enforcement under the Patriot Act. Although real estate purchases without mortgages are usually exempt from Patriot Act requirements, these transaction may still be subject to criminal money laundering statutes. As such, it is important to carefully review all representations and warranties made in real estate transaction documents, especially as it may require additional due diligence for all parties involved. It is important to "know your party" before entering into a real estate transaction While these provisions are often easily overlooked, the implications of compliance may be broad.
