

USA Patriot Act

Frequently Asked Questions about the Effect of the USA Patriot Act on Foreign Investment in US Real Estate

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Title III of the *Uniting And Strengthening America By Providing Tools Required To Intercept And Obstruct Terrorism Act* of 2001 (*Patriot Act*) amended the former *Bank Secrecy Act* and created new minimum due diligence obligations for certain defined financial institutions.

These financial institutions are required, *inter alia*, to establish an anti-money laundering program, establish a customer identification program, institute special due diligence measures when dealing with jurisdictions of primary money laundering concern and report suspicious activity to the Financial Crimes Enforcement Network (FinCEN) of the United States Department of Treasury. Real estate businesses of at least two types are defined financial institutions under the *Patriot Act*. The first includes “persons involved in real estate closings and settlements.” The second includes unregistered investment companies.

Question: *How does the USA Patriot Act affect foreign investors in US real estate?*

Answer: Despite enactment, the anti-money laundering and customer identification provisions of the *Patriot Act* have not yet been made applicable by regulation to “persons involved in real estate closings and settlements” and “unregistered investment companies.” In other words, persons involved in real estate closings and settlements, and

unregistered investment companies are subject to a temporary exemption from the anti-money laundering and customer identification program requirements of the *Patriot Act* until such time as FinCEN issues final regulations. There is no current timetable for the issuance of such regulations.

Nevertheless, FinCEN has undertaken certain regulatory activity with respect to “persons involved in real estate closings and settlements” and “unregistered investment companies.” On April 10, 2003, FinCEN issued an advance notice of proposed rulemaking with respect to persons involved in real estate closings and settlements that seeks information on the industry. This information eventually will be used to craft anti-money laundering and customer identification regulations. The proposed regulation did not define the term “persons involved in real estate closings and settlements” but indicated that the future definition may include real estate brokers, attorneys who represent the purchaser or the seller, banks, mortgage brokers (or other financial companies), title insurance companies, escrow agents, appraisers, and such investment vehicles as real estate investment trusts, real estate limited partnerships or entities commonly referred to as “syndicates” of real estate investors.

Similarly, on September 26, 2002,



FinCEN issued a proposed regulation on anti-money laundering programs for unregistered investment companies. As described in the proposed regulation, unregistered investment companies will likely include “a company that invests primarily in real estate and/or interests therein.” When it issues its final anti-money laundering regulations, FinCEN will require the four core elements mandated by statute:

- The implementation of internal policies, procedures and controls;
- The designation of a compliance officer;
- The conduct of ongoing employee training programs; and
- Independent audits to test the programs.

FinCEN’s final regulations on customer identification also will track the requirements of the statute, which require financial institutions to verify customer identities, maintain records and screen customers against lists of known or suspected terrorists.

Although FinCEN has not specified which lists of known or suspected terrorists must be checked, it will, at a minimum, include the “Specially Designated Nationals And Blocked Persons List” (SDN list) maintained by the Office of Foreign Assets Control of the United States Department of the Treasury (OFAC). The SDN list includes individuals and entities covered by one or more of the embargoes or sanctions programs administered by OFAC.

Question: *Must every participant in a US real estate investment or REIT be*

checked against the US government’s list of suspected terrorists?

Answer: As described above, the *Patriot Act* imposes certain obligations on defined financial institutions. Consequently, these institutions are required to screen the identity of individuals who seek to open accounts or invest in the US against lists of known or suspected terrorists. This customer screening generally includes all individuals who participate in a real estate investment fund or REIT.

Financial institutions responsible for investing in real estate in the United States implement these requirements in a variety of different ways. For example, a financial institution will screen the name of the customer or investor against the SDN lists and other lists. If the customer or investor is beneficially owned or controlled by another person or entity, the financial institution will attempt to determine the identity of that entity and screen it against the SDN list and other lists. If the investor is part of an offshore fund and the identity of the investor or its beneficial owners is difficult to obtain, some financial institutions will accept certifications from the fund or a foreign financial institution that performed the customer screening and can ensure that the investor is not on the SDN list or any other list. This procedure may change once FinCEN issues its final customer identification regulations.

It is important to remember that the *Patriot Act* imposes customer screening obligations on US financial institutions, not individual investors. Most of this screening is done using sophisticated screening software and is largely invisible to the customer or investor.

Question: *Can foreign investors buy a house in the United States without opening a US bank account?*

Answer: The *Patriot Act* does not require that foreign investors in US real estate must open a US bank account to complete the transaction. Rather, it requires US financial institutions whose services are likely to be used in the transaction to implement procedures designed to protect against money laundering and terrorist financing activities. In your example, even though payment is not routed through a US bank, a direct money transfer from an investors' German bank will still be evaluated under the *Patriot Act*. Specifically, once the final regulations go into effect, the mortgage brokers, title insurance companies, escrow agents and other "persons involved in real estate closings and settlements" will evaluate the payment from the German bank and, in all likelihood, process it without delay. As mentioned above, US financial institutions are largely bearing the cost of these new regulations and are implementing procedures in a manner that impacts legitimate customers and investors as little as possible while still detecting illegal activity.

Question: *Are there any examples where foreign real estate investors were negatively affected or rejected by the Patriot Act?*

Answer: One example includes a foreign investor who invested in US real estate through a joint venture between an offshore fund and a US real estate management company. The offshore fund, which had sophisticated customer screening software, detected the fact that an individual investor, subsequent to the closing of the fund, had been placed on

OFAC's SDN list. As a result, all interest and dividend payments to this investor were placed in a special, interest bearing account (i.e., "frozen" or "blocked" in OFAC parlance), and reported to OFAC. None of the other investors in the fund was adversely impacted in any way.

Question: *Will foreign companies that trade with countries that the US has put on their trade embargo list be excluded from investing in US real estate?*

Answer: As a general rule, US persons (companies and individuals), including US entities involved in real estate, are prohibited from engaging in any transactions with entities subject to US embargoes or trade sanctions. An entity may be subject to a US embargo or trade sanction either by being named on the SDN list or other list of restricted parties. The entity also may be subject to a US embargo or trade sanction by being part of a government or nation against which the US maintains a "territory based" embargo or sanction (e.g., Cuba, Iran, Sudan). As a corollary, and subject to the exceptions outlined below, US persons generally are not prohibited from engaging in a transaction with an entity that is not the subject of US embargoes or sanctions, even if the entity trades with companies or entities that are subject to US embargoes or sanctions.

The exceptions to this rule include the following:

1. The particular real estate transaction at issue may involve, directly or indirectly, investors or parties subject to US embargoes or trade sanctions. For example, if a foreign company is purchasing US real estate and is backed by several investors, one of which happens to be a person located in Iran, property

under the ownership and control of a US person and company cannot be transferred to the foreign company under US law. In addition, no US persons or companies could be involved in the real estate transaction.

2. Depending on the nature and extent of the foreign company's involvement in embargoed or sanctioned countries, the US Government may determine that the foreign company is an "agent" or "representative" of an embargoed or sanctioned country. Thus, the US Government may add the foreign company to the SDN list which would mean that no US person or company could transact business with the foreign company. It also would mean that no real estate subject to the ownership or control of a US person or company could be transferred to the foreign company.
3. Currently, members of US Congress have introduced legislation seeking

to expand the jurisdiction of US trade embargoes to activities of companies owned or controlled by US persons or companies (as is already the case under the US embargo of Cuba). While this legislation has not been passed, and is unlikely to pass, it indicates that there is political interest in the US for the extraterritorial expansion of US embargoes and sanctions. In addition, US institutional investors, such as state and city pension funds, have indicated that they will divest their holdings in companies (US or foreign) that engage in trade with US embargoed or sanctioned countries. Thus, to the extent that a foreign company is a public company, traded on a US stock exchange, US investors may exert intense financial pressure against the foreign company in an effort to persuade the foreign company to cease trade activities in embargoed or sanctioned countries. ★

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