FEDERAL STANDARD ABSTRACT
TITLE NEWS

Issue #93 July 2012

The Foreign Client and Banking

Suppose your dream comes true: a wealthy foreign investment group decides to enter the U.S. market and hires you to represent it in the purchase of a multimillion dollar property, and which has the potential to lead to many other similar transactions. What could go wrong? You work out the contract of sale with the seller and you refer the client to the lenders specializing in commercial New York real estate. Somewhat later, while you are working on your due diligence (e.g., title report -- thank you!-, environmental report, zoning analysis, and leases review) your client reports that no lender is willing to extend credit, at least not within the time constraints dictated by the contract. Something about no principal of the borrowing group having a Tax Identification Number (TIN) or presence in the U.S. The client is not pointing fingers, but is probably wondering whether that was something you should have known and warned about. The client reluctantly decides to finance the sale with its own funds in order to avoid default and losing the down payment. And when you thought all was well, you schedule the closing and the worst part comes: you send the client back to the banks just to open the operating account for the building and the banks will not even open an account! How on Earth can your client own and manage real property without an account where to deposit rent checks and pay operating expenses? Sure, the LLC that you formed to own the property is a New York LLC and has received a TIN, just like you've done for your previous clients. This time, however, the banks are saying that a New York LLC with a duly-issued TIN is not enough. What is going on?

The root of the problem is section 326 of the post 9/11 Patriot Act (which is also responsible for the typical patriot searches). In an effort to curb money laundering and the financing of terrorist operations, the federal government passed a series of regulations which require banks to carry out due diligence on their customers. These regulations, known as the "know your customer" or "KYC" regulations, generally require banks to identify the customer with established procedures and to inquire about the customer's business and source of funds. Identifying the customer entails reviewing every corporate layer to determine the identity of the principals and cross-checking it with government records. To achieve this, banks must create and file their own procedures which usually exceed the specific regulatory requirements. Different banks adopt and file procedures appropriate to their size, business and target clients. For example, an international lender may have procedures to satisfy the KYC regulations when foreigners wish to open accounts, but a local lender may not because its target market is only local.

What this all means in the commercial real estate market is troublesome. Commercial real estate financing is mostly a local industry. Many of the lenders best suited for such financing may not have procedures in place to comply with KYC when foreigners are involved. As a result, a lender with no procedures to cross-check foreign documents (e.g. personal I.D. issued by a foreign government) will not be able to establish a banking relationship with a foreigner, regardless of whether the relationship involves credit or is just an application to open an account.

So what can be done? Simply going to big international lenders is not the answer: their local real estate divisions may not be that different from other local banks. There is one easy solution, but it depends on the circumstances. KYC applies to all banks doing business in the U.S. That means that an international bank doing business in the U.S. must comply with KYC worldwide, not just in its U.S. branches. So, if you are lucky, your client may already have a banking relationship in its home country with a bank that complies with KYC. Unbeknownst to the client, that foreign branch would have a procedure that takes into consideration the documentation available in the jurisdiction. That foreign branch would also have a file with the client's KYC review. In those circumstances, the Patriot Act allows a short cut: as a form of compliance with KYC, a bank may accept a certification from another bank indicating that it has appropriate KYC procedures in place and that the client has been satisfactorily reviewed. With that certification, the bank may begin a banking relationship. See 31 CFR §103.121 (b)(6). Unfortunately, a bank that has no procedures for foreign clients might not be unaware of this, which means that it could take a rather long time to approve, if at all.

And if the client does not bank with a foreign branch that complies with KYC, well, submit to the bank whatever you can find: U.S. persons who know the principals and can make representations as to them, foreign government-issued documentation, letters from non-KYC compliant banks laying out a long term relationship, information about the seller to show that credit is not to finance terrorism but a legitimate U.S. person or business, business records to show that the clients' funds were the product of a legitimate business, and even offer to pay for a global research company search on the principals and their businesses. Cross your fingers and hope for the best.