NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

November 25, 2002

Financial Crimes Enforcement Network
P.O. Box 39
Vienna, Virginia 22183-1618

Re: <u>NPRM -- Section 352 Unregistered Investment Company Regulations</u>

Ladies and Gentlemen:

The National Association of Real Estate Investment Trusts ("NAREIT") appreciates the opportunity to comment on the Notice of Proposed Rulemaking concerning anti-money laundering programs for unregistered investment companies (the "Proposed Rule") recently issued by the Financial Crimes Enforcement Network ("FinCEN"). The Proposed Rule implements Section 352 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT"), which requires that certain financial institutions establish anti-money laundering programs. The Proposed Rule applies the anti-money laundering program to certain "unregistered investment companies," including, with a few exceptions, real estate investment trusts ("REITs").

The Proposed Rule defines an "unregistered investment company" to "include only those companies that give an investor a right to redeem any portion of his or her ownership interest within two years after the interest was first purchased." The Proposed Rule also states that "this 'redeemability' requirement is likely to exclude publicly traded REITs and entities that require lengthy investment periods without the ability to redeem assets, including private REITs" since "[t]hese types of illiquid companies *are not likely to be used by money launderers*." (emphasis added). NAREIT appreciates FinCEN's efforts to exempt most REITs from the anti-money laundering regulations and agrees with FinCEN that REITs and their affiliated UPREIT (or umbrella partnership) structures (discussed below) are not likely to be used by money launderers. The Proposed Rule, however, would require virtually all public REITs that employ the UPREIT structure for operational efficiency to comply with the anti-money laundering regulations.

NAREIT is the national trade association for public real estate companies. Our members include REITs and other businesses that own, operate and finance the development of income-producing real estate, as well as firms and individuals who advise, study and provide services to these businesses. NAREIT and its

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members recognize the critical importance of denying terrorists and other money launderers access to readily available funds. We also recognize FinCEN's challenge, as noted in the Proposed Rule, to develop regulations that accomplish this goal "without unnecessarily burden[ing] businesses not likely to be used to launder money." We believe that REITs and their affiliated UPREIT structures are inherently unattractive to would-be money launderers or terrorist financiers. Consequently, we believe that it is unnecessary to apply anti-money laundering regulations to REIT and UPREIT activities in order to protect the public interest.

This letter describes the modern-day REIT industry and the use of the REIT and affiliated UPREIT structure in the public and private real estate capital markets. We are hopeful that, after reviewing this letter, FinCEN will conclude that, given the current uses of the REIT and UPREIT structures, it is highly unlikely that money launderers or terrorist financiers will use the REIT industry for money laundering activities. Consequently, we hope the FinCEN will further conclude that today's REITs should not be categorized as "financial institutions" or "unregistered investment companies" under the Bank Secrecy Act ("BSA") or USA PATRIOT.

1. Executive Summary

In summary, NAREIT believes:

- REITs and their affiliated UPREIT structures are not "financial institutions" or "investment companies" either under a plain meaning of those terms or according to the definition of investment company Congress adopted in the Investment Company Act of 1940.[1] REITs and their affiliated UPREIT structures are operating companies that own and manage real estate assets, and their customers are the tenants who use those assets. REITs do not fit comfortably into any of the categories of "financial institution" subject to the BSA, nor did Congress intend to subject REITs to BSA requirements. The legislative history of the BSA, as amended by USA PATRIOT, does not suggest that Congress considered REITs or their affiliated UPREIT structures to be financial institutions or unregistered investment companies that could be employed by money launderers.

Even if REITs are classified as "financial institutions" or "investment companies," granting an exemption from BSA coverage to a REIT only if it does not "permit … an owner to redeem his or her ownership interest within two years of the purchase of that interest," is not necessary to protect the public interest for the following reasons:

- Money launderers want to put cash into the system, layer it a number of times, and take it out rapidly. Any REIT or affiliate that issues UPREIT interests only for real property held by the contributor for at least two years prior to the contribution is not at risk for

[1] Section 3(c)(5)(C) of the Investment Company Act, for example, specifically exempts from the definition of "investment company" entities primarily engaged in "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." 15 U.S.C. 80a-3(c)(5)(C).

money laundering and should not be treated as an investment company subject to USA PATRIOT.

- Many UPREITs permit holders of interests in the UPREIT a “redemption” right. In the substantial majority of instances, however, these redemption rights are subject to contingencies that render the investment unattractive as a vehicle for money laundering. For example, in virtually all cases, the REIT makes the decision as to whether the redemption will be satisfied in cash or in shares of common stock of the REIT. The redeeming party cannot be certain as to whether he or she will receive cash.

- To comply with concerns raised by the Securities and Exchange Commission and for other business reasons, many other UPREITs permit redemptions after one year. Any “lock-up” period impedes the layering of investment that is an essential element of money laundering and, therefore, is a significant obstacle to the process.

- Any potential threat that REITs and their affiliated UPREIT structures will be exploited for money laundering purposes comes from new investors seeking to transmit money through REITs, not from existing investors keeping their money there. Consequently, we suggest that any application of Section 352 to REITs and their UPREIT structures be made only on a prospective basis.

2. REITs and UPREIT Structures and Their Uses

Congress first introduced REITs into the Internal Revenue Code (the “Code”) with the adoption of the Real Estate Investment Trust Act of 1960. Since then, the REIT industry has grown significantly. Today there are 177 publicly traded REITs, 140 of which are traded on the NYSE, as well as numerous private REITs.

One of the major limitations on REIT activities under the original legislation was the provision that excludes from the definition of qualifying rents from real property any amount of rent from a property if the REIT furnishes or renders services to the tenants of such property, or manages or operates such property, other than through an independent contractor. This “independent contractor” requirement was a significant obstacle to the growth of the REIT industry. Because of this requirement, REITs were perceived as *passive investment vehicles*, and not as operating companies. However, in the Tax Reform Act of 1986, Congress permitted REITs to manage and operate their own properties to the same extent that various tax-exempt entities such as pension funds, charities and universities could directly manage and operate their properties without incurring “unrelated business taxable income.” As is evident from the growth of the REIT industry since 1986, this significant change has allowed REITs to become stand alone operating companies without relying on externally advised independent contractors. *REITs are no longer passive investment vehicles. They are active operators, managers and developers of significant real estate portfolios.* Indeed, today, eleven publicly-traded REITs with UPREIT structures are included among companies in the S & P indices.

UPREIT is an acronym for umbrella partnership real estate investment trust. It refers to a REIT whose *real properties are held by, and operations are conducted through, a single partnership* (or by two or more partnerships that are under the umbrella of a single partnership) known as the "operating partnership" ("OP"). Typically, the REIT, or a wholly-owned subsidiary of the REIT, is the general partner of the OP, owns a substantially majority of the partnership interests in the OP and, consequently, controls the partnership. The REIT's shareholders, through their ownership of REIT securities, hold an indirect interest in the OP.[2]

UPREIT formation transactions offer numerous benefits to a property contributor. Principal among these is the ability of the property contributor to defer recognition of gain for federal income tax purposes.[3] Almost all property contributors are taxable investors who would otherwise recognize gain if they sold their property for cash. Generally, this deferral of gain is accomplished through the non-recognition provisions of Section 721 of the Code. If the property contributor could avoid recognition of gain and contribute his or her real estate assets to the REIT in exchange for shares of common stock, there would be no need for the UPREIT structure. UPREIT formation transactions also permit a property contributor to diversify its assets and gain sophisticated property management for the contributed property. Finally, it is important to note that most, if not all, property contributors want to invest in the equity of the OP and, indirectly, the REIT. If the property contributor were not interested in the regular distributions that a REIT and it affiliated UPREIT are required to make to their equity holders and the underlying long-term investment, he or she would likely sell the properties that are the subject of the contribution and use the cash proceeds from the sale to invest in something other than the REIT's securities.

In a typical UPREIT formation transaction, the existing owners and operators of real estate assets contribute those assets in a tax deferred contribution transaction to the OP in exchange for OP units of limited partnership interests ("OPUs"). The REIT, by accessing the public equity markets or otherwise, contributes cash to the OP in exchange for its share of OPUs issued by the OP. The cash is generally used to pay down the indebtedness on the contributed real estate so that the REIT's share of the cash flow from the OP can be used to support the payment of a dividend to the REIT's shareholders. In addition, each outstanding share of common stock of the REIT is generally matched with an OPU such that the common stockholders of the REIT are effectively indirect holders of OPUs.

Generally, OPUs are redeemable one year following the contribution of the real estate to the OP. Several factors contributed to the development of this practice in the REIT industry. For example, the Securities and Exchange Commission regularly requires a one year moratorium on the redemption of OPUs issued in the initial formation and public offering of a REIT due to

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2 An analogous structure also used by REITs is the so-called "downREIT" structure. A downREIT is structured much like an UPREIT, but the REIT owns and operates properties other than through its interest in the OP. The comments in this letter concerning UPREITs apply equally to the downREIT structure.

3 The Internal Revenue Service has recognized the deferral of gain through an UPREIT formation transaction. See Example 4 under section 1.701-2(d) of the regulations promulgated under the Code.

concerns regarding the integration of the private (issuance of the OPUs) and the public (sale of the REIT common stock) offerings. In limited circumstances, this one year lock-up period may be shortened. The redemption provisions of most OP agreements also provide that the REIT general partner can decide to satisfy a redemption request *at its election* either *with cash* equal to the per share value of the REIT's shares of common stock, *or with shares* of the REIT's common stock on a one-for-one basis. This practice developed in the industry to permit the REIT to satisfy a redemption request in a situation in which issuing shares of REIT common stock might trigger the "excess share" provisions of the REIT's charter.

For example, if a property contributor contributes $100 million in real estate to an OP that is 80% leveraged and the REIT contributes $80 million in cash to the OP following an initial public offering to pay all outstanding indebtedness on the property, there would likely be ten million OPUs, with eight million OPUs held by the REIT general partner and two million OPUs held by the original property contributor. The REIT's capital stock would consist of eight million shares of common stock to match the REITs share of the outstanding OPUs. In addition, while the shares of the REIT's common stock are publicly traded, the OPUs generally are not, and each OPU is valued from time to time based on the per share value of the REITs shares of common stock in the public market place. Therefore, if the initial per share price of the REIT's common stock is $10, the OPU value is $10 per unit. As the public shareholders trade the REIT's equity, the market value of those shares dictates the mark-to-market value of the OPUs. If the original holder of the OPU requested redemption of his or her units five years following the initial formation of the UPREIT at a time when the REIT's shares were trading at $15 per share, the REIT could satisfy that redemption request with cash equal to $15 per OPU or with one share of the REIT's common stock for each OPU redeemed.

It is important to note that most holders of OPUs do not avail themselves of their right to redeem their OPUs because to do so would cause them to recognize the deferred gain that they originally avoided by contributing their properties to the OP in the first instance. For this reason, while there are over 100 OPs affiliated with publicly traded REITs, there have not been significant redemptions of OPUs since the first public UPREIT structure in 1992. It would be contrary to the principal purpose for issuing OPUs in connection with property contributions for a property contributor to request the redemption of his or her OPUs shortly following the original contribution of property.

Following the initial formation of the UPREIT, additional properties from other potential portfolios that fit strategically with the UPREIT's properties can be contributed to the OP on a tax deferred basis in exchange for OPUs that are redeemable for cash or shares of the REIT's common stock (at the discretion of the REIT or OP). Many UPREITs have experienced significant growth in their assets and resulting net operating income through property contributions following their initial public offering. In each instance, however, the general premise upon which the UPREIT structure is used remains the same: namely, the deferral of gain recognition associated with the contributed portfolio together with the investment in the REITs equity securities.

Not all subsequent contributions are subject to a one year lock-up on the redemption of OPUs. Even in those situations, however, most holders of OPUs do not have the right to determine whether they receive cash or shares of the REIT's common stock upon redemption. Generally, the REIT or the OP determines the form of the consideration to be received by the holder of OPUs upon redemption. However, a property contributor could negotiate the right to determine the form of consideration to be received upon redemption of his or her OPUs, or he or she could provide that the sole form of consideration to be received upon redemption of the OPUs is cash.

It would be logical for a property contributor who was contributing a relatively small portfolio of properties to an OP to attempt to negotiate for the right to receive only cash upon the redemption of his or her OPUs. The rationale for this position rests in the fact that under the safe-harbor provisions of Rule 144 of the Securities Act of 1933, the holding period for OPUs cannot be "tacked" to the holding period of the shares of capital stock issued by the REIT upon redemption of the OPUs. Accordingly, any shares issued by the REIT upon redemption of the OPUs would have to be registered with the Securities and Exchange Commission or would be restricted upon resale. The property contributor would prefer to control the decision regarding the form of consideration to be received upon redemption of the OPUs. On the other hand, particularly with respect to large OPU positions, the REIT has a strong preference for controlling the decision so that it can be in a position to preserve the UPREIT's cash reserves and not further encumber the OP's properties to satisfy the redemption solely with cash. Additionally, if a REIT permits the property contributor to put the OPUs to the REIT for cash, the REIT must account for such interests as debt under generally accepted accounting principles.

In the substantial majority of cases, management and the directors of the REIT generally know those individuals who contribute properties to an OP in exchange for OPUs. REIT management teams spend a significant amount of time and attention reviewing those assets which they believe strategically fit their company's existing portfolio. Those management teams are almost always aware of the property contributors to the OP principally because they are either competitors of the REIT or have historically operated in a geographical area in which the REIT would like to commence (or augment its existing) operations. In addition, it generally takes a significant amount of time to negotiate a property contribution agreement because it is a highly customized agreement. Almost all property contributors are interested in negotiating tax protection covenants relating to the contributed assets because if the OP disposes of those assets in a taxable sale at any time following the contribution of the assets, the original property contributor will recognize the gain that he or she intended to avoid at the time of the contribution. The documentation surrounding the contribution of real assets to an OP is not the type of streamlined documentation that would be attractive to a would-be money launderer.

3. REITs and UPREITs Should not be Deemed to be "Financial Institutions"

We do not believe that REITs or UPREITs should be treated as "financial institutions" subject to the BSA or USA PATRIOT. We believe that Congress did not intend for the BSA or USA PATRIOT to cover REITs and their subsidiaries. Moreover, no evidence suggests that REITs are being used, or are a type of entity likely to be used, by criminal or terrorist money launderers.

No Evidence of Intent of Congress to Cover REITs and Their OPs

The bill that formed the core of the original BSA did not include "investment companies" in its definition of financial institutions. *See* H.R. 15073 (91st Congress, 2nd Session), Sec. 203. The bill covered "any business which supplies a means for transferring or transmitting funds or credits domestically or internationally[.]" H.R. Rep 91-975 at 1970 USCCAN, vol. 2, p. 4403. As a result, it defined financial institutions to include such businesses as insured and uninsured depository institutions, issuers of travelers checks, and operators of credit card systems. The term "investment banker or Investment Company" was one of "a number of business activities" added as part of the compromise between competing House and Senate versions of the bill that would ultimately become the BSA. *See* Conf. Rep. 91-1587 at 1970 USCCAN vol. 2 p. 4413. The Conference Report described the Senate's addition as "broaden[ing] the coverage of the title," but at the same time it asserted that none of the Senate's additions changed the purpose of the bill. *Id.* p. 4412. This strongly suggests that the Senate's aim in broadening the coverage of the bill – which at the time primarily obligated financial institutions to report currency transactions – was intended to more completely cover those institutions that transferred or transmitted funds or credits domestically or internationally.

REITs and their affiliated OPs are primarily engaged in the business of managing and operating real property assets – not transmitting funds or credits either domestically or internationally. If REITs transmit funds, it is merely as an incident to their primary business. Such activity is no more significant than the transmittal of funds or credits by any other non-financial business. We believe that the BSA as originally passed was not intended to cover industrial corporations merely because they handled and distributed funds to employees, shareholders and vendors as part of their ordinary corporate activities. For the same reasons, we believe that the BSA as originally passed was not intended to cover REITs.

We further believe that neither the 1998 nor the 2002 amendments to the BSA changed this original intent.

- The Money Laundering Prosecution Improvements Act of 1988 amended the BSA by adding "*persons* involved in real estate closings and settlements (emphasis added)" to the definition of financial institutions. Pub. L. 100-690, Title VI, Subtitle E, Section 6185(a). We believe that if Congress had intended this amendment to cover real estate-related entities generally, it would have used the term "*businesses*" rather than "*persons*" – as it did in the same amendment when it defined a financial institution to include any "*business* engaged in vehicle sales[.]" *Id.* (emphasis added). We also believe that if Congress had been concerned about entities engaged in any type of real estate-related activities, it would not have limited the scope of the BSA solely to real estate closings and settlements. We believe that this amendment was intended to cover real estate settlement agents who, on occasion, will handle cash down payments. This is a logical implication, given that even in 1988 the primary focus of the BSA was on tracking cash transactions.

- USA PATRIOT instructed the Treasury Department, jointly with the Board of Governors of the Federal Reserve System and the Securities and Exchange Commission, to submit a report on "recommendations for effective regulations to apply [the BSA] to investment companies" by October 26, 2002. Pub. L. 107-56, Title III, Section 356(c)(1). Congress further limited the scope of the required report stating that "the term 'investment company' (A) has the same meaning as in section 3 of the Investment Company Act of 1940 … ; and (B) includes any person that, but for the exceptions provided for in paragraph (1) or (7) of section 3(c) of the Investment Company Act of 1940 … would be an investment company." Pub. L. 107-56, Title III, Section 356(c)(2). REITs are not investment companies by virtue of section 3(c)(5)(C) of the Investment Company Act, which exempts institutions primarily engaged in "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." 15 U.S.C. 80a-3(c)(5)(C). Consequently, we believe that Congress did not intend that USA PATRIOT sweep REITs or Ops into the definition of investment companies.

Upon our review of the legislative history, we believe that Congress did not intend for the BSA to apply to REITs and institutions like them, either before or after the passage of USA PATRIOT.

No Evidence of Threat of Money Laundering Through REITs

Congress passed USA PATRIOT in the aftermath of the events of September 11, 2001, with the clear overall purpose of "increas[ing] the strength of United States measures to prevent, detect, and prosecute international money laundering and the financing of terrorism." Pub. L. 107-56, § 302(b)(1). Congress did not, however, want to impose the new requirements of USA PATRIOT broadly on every business that might qualify as a "financial institution" under the definitions of the Bank Secrecy Act. For example, Congress made explicit that USA PATRIOT is intended "to ensure that all *appropriate* elements of the *financial services industry* are subject to *appropriate* requirements to report potential money laundering transactions to proper authorities[.]" Pub. L. 107-56, § 302(b)(11) (emphasis added).

FinCEN recognized the potential burdensome effects of an overly expansive regulatory scheme when it stated in the Proposed Rule that "an overly expansive definition of 'unregistered investment company' would unnecessarily burden businesses not likely to be used to launder money." 67 Fed. Reg. 60618. FinCEN also recognized that government resources are scarce when it stated in the Proposed Rule that "an overinclusive definition of the key term 'unregistered investment company' would bring within the scope of the BSA's anti-money laundering requirements so many entities as to tax [the] resources of the federal regulatory agencies charged with oversight of the financial institutions, diminishing the effectiveness of that oversight." *Id.*

Cognizant of these possible adverse consequences, FinCEN has carefully crafted USA PATRIOT regulations issued to date to narrowly define covered entities in order to capture those financial institutions with significant risk of being exploited by money launderers without capturing financial institutions with little or modest risk of being exploited. FinCEN's proposed rule applying the Section 352 anti-money laundering program requirement to insurance companies provides a good example of this analysis. The proposed rule for insurance companies narrowly defines "insurance companies" in a manner that excludes virtually all providers of health, property, casualty, mortgage and title insurance. FinCEN crafted this definition based on its belief that "the most significant money laundering and terrorist financing risks in the insurance industry are found in life insurance and annuity products." 67 Fed. Reg. 60626. FinCEN supports this belief by pointing to specific instances of money laundering through insurance, which FinCEN characterizes as having been "generally … confined to life insurance products." 67 Fed. Reg. 60627.

In crafting the Proposed Rule, FinCEN made a determination about the risks of money laundering and terrorist financing associated with investment companies in general stating that "[m]oney laundering is more likely to occur through these entities [investment companies] at the 'layering' stage of the money laundering process, which generally requires the money launderer to be able *to redeem* his or her interests in the company." 67 Fed. Reg. 60619 and note 21 (italics added). FinCEN based its definition of the key term "unregistered investment company" on that determination of risk.

Leaving aside the technical definitions discussed above, REITs are not "investment companies" under any plain meaning of that term. REITs are operating companies.[4] REITs are a variation on Subchapter C corporations under the Code in that they do not pay a corporate level tax, and therefore they are a more favorable tax alternative to "regular" corporations. The fact that both REITs and regulated investment companies ("RICs") are taxed under Subchapter M of the Code should not be used to infer that REITs are investment companies. Although the Real Estate Investment Trust Act of 1960 used the RIC vehicle as a paradigm to permit REITs a dividends paid deduction, this does not mean that REITs and their affiliated UPREITs are themselves investment companies, registered or unregistered.

We also believe that there is little money laundering risk associated with the establishment of a REIT or of an UPREIT structure. Unlike investment companies who keep significant cash reserves on account to address daily redemptions, REITs and their affiliated UPREIT structures do not keep significant amounts of cash on their balance sheet because there are not daily or even frequent redemptions of their shares or OPUs. We do not believe that simply because a company "invests primarily in real estate and/or interests therein" – a definition that encompasses most REITs and their affiliated UPREITs– that it is at any actual risk of being used in the "layering" or any other stage of money laundering. Also, OP property contributors are taxable individuals who have significant built-in gain in their assets. Generally management and the directors of the

4 The Internal Revenue Service concluded in Revenue Ruling 2001-29, 2001 I.R.B. 1348, that a REIT can be engaged in the active conduct of a trade or business within the meaning of Section 355(b) of the Code by virtue of functions with respect to rental activity that produces income qualifying as rents from real property within the meaning of section 856(d) of the Code.

REIT well know such contributors before they commence negotiations relating to the contribution of assets to the OP.

4. **Seasoning Requirement for Contributed Property is Sufficient to Prevent Money Laundering Activities.**

Even if FinCEN takes the position, contrary to our analysis, that REITs are "financial institutions" subject to the BSA and USA PATRIOT, we believe that far more REITs should be exempted from coverage than the Proposed Rule currently exempts.

FinCEN indicates that the primary money-laundering risk associated with investment companies is "the creation of complex layers of financial transactions." 67 Fed. Reg. 60619 n. 18. FinCEN's concern that a REIT and its affiliated UPREIT could be used as part of a money launderer's layering strategy appears to be that the money launderer will purchase real property, exchange it for OP units in an UPREIT, and redeem those OP units for cash – all in a relatively short period of time. But in that case, focusing solely on slowing down redemption by requiring that a REIT mandate a lengthy lock-up period for OP units is not necessary. It is fully as effective to deter money laundering by exempting from the anti-money laundering regulations a property contribution if the property owner has held the property to be contributed to the UPREIT for at least two years prior to the contribution.

Money launderers want to put cash into the system, layer it a number of times, and take it out rapidly. If a money launderer has to own real estate for two years before he can convert it into cash through a REIT and its affiliated UPREIT, that two year delay will be such a significant disincentive that the money launderer will choose other avenues to attempt to launder funds. As a result, we think that the anti-money laundering regulations should not apply to a property contribution if the property owner has held the property to be contributed to the UPREIT for at least two years prior to the contribution.

5. Contingent Redemption Rights Should not be Treated as Right to "Redeem"

The Proposed Rule exempts from the definition of "unregistered investment company" an investment company that does not "permit … an owner to redeem his or her ownership interest within two years of the purchase of that interest[.]" 67 Fed. Reg. 60623 (proposed 31 C.F.R. 103.132(a)(6)(i)(B).[5] FinCEN appears to be drawing a risk-based line between an investment vehicle that permits such a redemption within two years of purchase, which is at risk for money laundering, and an investment vehicle that does not permit redemption within two years of

[5] Because the term "redeem" is not defined in the Proposed Rule, it is not clear how far the provisions relating to redemption are intended to extend. For example, a number of REITs and their affiliated UPREITs have no "redemption" rights but have only "exchange" rights that operate in substantially the same manner as the redemption rights. Similarly, any REIT or real estate company that issues preferred shares that offer the investor the right to "redeem" those shares at the investor's election (a common provision for preferred stock) would fall within the scope of the Proposed Rule if it did not, or could not, list those preferred shares on a stock exchange.

purchase, which is not at risk. FinCEN's justification for establishing a redeemability requirement appears to be that "liquidity … makes certain financial institutions attractive to money launderers," 67 Fed. Reg. 60619, that a two-year mandatory lock-up period makes an investment sufficiently illiquid that the investment vehicle ceases to be at significant money laundering risk, and implicitly that any lock-up rule that "permits" redemption creates a significant money laundering risk.

We believe that the mere fact that holders can redeem OPUs in less than 24 months does not necessarily create any risk of money laundering activities:

- Generally, a holder of OPUs only has the right to put its interests to the REIT or OP in exchange for shares of REIT common stock. The decision whether to settle a redemption in cash, as opposed to REIT shares, is generally up to the REIT or OP itself. A would-be money launderer with real property cannot be sure that he can trade that real property for REIT interests that can be redeemed at some specific time in the future for cash.

- A would-be money launderer forced to redeem OPUs for REIT marketable securities would then have to sell the securities in order to realize the cash needed for the next layering transaction. In the case of a private REIT, the lack of liquidity with respect to this sale would render the investment unattractive as a vehicle for money laundering. In the case of a public REIT, this sale would have to go through a securities broker-dealer, subjecting the contributor to the broker-dealer's anti-money laundering compliance procedures.

Given these procedural obstacles to a transaction with a REIT, the REIT's right to control the outcome of any redemption request, and the money launderer's desire to avoid the sort of scrutiny that the procedures associated with a REIT asset exchange involve, we believe that the would-be money launderer with real property will not want to dispose of that property through a transaction with a REIT. Instead, the money launderer is likely to sell the real estate for cash. Additionally, the money launderer with cash rather than real estate assets has no particular reason to invest in a REIT rather than in any other company. REITs are known for generating significant income streams for their investors who continue to hold REIT shares or OPUs, but so are utilities, or industrial corporations through preferred stock issuances. If these other types of companies are not considered "investment companies" with anti-money laundering responsibilities, REITs should not be either.

We think that the disincentive to a money launderer of anything less than an absolute right to redeem an investment for cash at a time certain is very great. In a typically OPU redemption transaction, the REIT or the OP determines the form in which the redemption right will be satisfied, as well as the timing of the redemption. Such a transaction is unattractive to a would-be money launderer since it deprives him of control over the ability to launder his money. We therefore think that institutions that grant an owner anything less than an irrevocable, absolute right to redeem an investment for cash on demand should not be subject to anti money-laundering program requirements.

6. A One-Year Lock-Up Period Should be Deemed to Render Redemption Rights Harmless

As FinCEN points out, the primary money-laundering risk associated with investment companies is that they will be used for layering, a process that involves "the creation of complex layers of financial transactions." 67 Fed. Reg. 60619, n. 18. The effectiveness of layering is directly proportional to the number of layers that can be created – which, in turn, is a function of the permissible velocity of transactions. *Any* lock-up period significantly impedes the ability of a would-be money launderer to use an investment in a REIT for layering purposes.

The standard practice in the REIT industry is to impose a one year moratorium on the redemption of OPUs issued in a property contribution transaction. We believe that this practice of imposing a twelve month lock-up period makes a REIT investment so disfavored for layering purposes that money launderers will avoid it.

We also note that generally accepted accounting principles differentiate between investments based on the time that such investments are expected to be held. Short-term investments are those investments expected to be held for one year or less, and long-term investments are expected to be held for more than one year. We believe that this classification indicates a consensus that investments held for twelve months or longer are acquired for long-term holdings and are not likely to be used for money laundering purposes.

We believe the Proposed Rule should adopt a time frame consistent with the current one-year lock-up period common in property contribution transactions, and consistent with other conceptions of short-term and long-term time horizons, for the lock-up period deemed to make an investment harmless for money laundering purposes.

7. No Retroactive Application

Finally, even if it is asserted that REITs and UPREITs are subject to the threat of being exploited for money laundering purposes, FinCEN has acknowledged that the threat comes from new investors seeking to transit money through REITs and UPREITs, not from existing investors keeping their money there. In the absence of evidence that there is a significant risk of money laundering by current REIT investors, we suggest that the Section 352 requirement be applied to businesses like REITs and UPREITs only when they allow in new investors on terms that permit the use of investments as money laundering vehicles.

8. Suggested Changes to the Proposed Rule

We see no persuasive reason for subjecting REITs to the same anti-money laundering requirement as that which applies to investment companies such as mutual funds or hedge funds. Congress never intended that REITs be treated as investment companies, and the money laundering risks associated with REITs are far smaller than those associated with investment companies. For these reasons, we respectfully urge FinCEN to change the Proposed Rule by deleting proposed 31 C.F.R. 103.132(a)(6)(i)(A)(3), releasing REITs from the possibility of being subjected to an anti-money laundering program requirement that is inappropriate to the risks associated with them.

Absent this revision, we respectfully urge FinCEN to change the Proposed Rule so as to avoid capturing the REITs to which anti-money laundering risks do not apply. We think this can be done in two ways.

- First, proposed 31 C.F.R. 103.132(a)(6)(i)(B) can be changed to read as follows: "That permits an exchange of interests in real property for ownership interests less than two years after the receipt, through purchase or otherwise, of those interests in real property." This will cause the Proposed Rule not to apply to REITs that acquire "seasoned" real property exchanged for UPREIT interests. As we have noted above, such a seasoning requirement is unattractive to would-be money launderers because it impedes the efficiency of the money launderer's layering strategy, and it therefore renders REITs that impose such a requirement at minimal risk for being used for money laundering purposes.

- Second, a new 31 C.F.R. 103.132(a)(6)(i)(B)(2) can be added, to read as follows: "That grants an owner the absolute and irrevocable right to redeem his or her ownership interest for cash within one year of the purchase of that interest from the company." This will exempt from the Proposed Rule REITs that do not give investors the unilateral right to redeem an investment for cash. This inability to demand cash is very unattractive to would-be money launderers, though of little consequence to the typical bona fide REIT investor. REITs that prohibit an investor from demanding cash upon conversion should be at minimal risk of being used for money laundering purposes.

Finally, in order to avoid an unjustifiable retroactive application of the Proposed Rule, a new 31 C.F.R. 103.132(a)(6)(i)(B)(3) can be added, to read as follows: "that grants such a right after the effective date of this section;".

We hope that our comments are helpful. We would be happy to meet with you at your convenience to discuss the matters raised by this letter in greater detail. Please call me or Rob Cohen, NAREIT's National Policy Counsel, at 202-739-9400, or Gil Menna of Goodwin Procter LLP at 617-570-1433, if you should have any questions.

Respectfully submitted,

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