

(BILLING CODE: 4810-02-P)

DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506-AA28

Financial Crimes Enforcement Network; Anti-Money Laundering Program Requirements for “Persons Involved in Real Estate Closings and Settlements”

AGENCY: Financial Crimes Enforcement Network (“FinCEN”), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: FinCEN is in the process of implementing the requirements delegated to it under the USA Patriot Act of 2001, in particular the requirement pursuant to Section 352 of the Act that financial institutions establish anti-money laundering programs. The term “financial institution” includes “persons involved in real estate closings and settlements.” FinCEN is issuing this advance notice of proposed rulemaking (“ANPRM”) to solicit public comments on a wide range of questions pertaining to this requirement, including how to define “persons involved in real estate closings and settlements,” the money laundering risks posed by such persons, and whether any such persons should be exempted from this requirement.

DATES: Written comments may be submitted on or before [INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Commenters are encouraged to submit comments by electronic mail because paper mail in the Washington, D.C., area may be delayed. Comments submitted by electronic mail may be sent to regcomments@fincen.treas.gov with the caption in the body of the text, “ATTN: Section 352 – Real estate settlements.” Comments may also be submitted by paper mail to FinCEN, P.O. Box 39, Vienna, VA 22183-0039, “ATTN:

Section 352 – Real estate settlements.” Comments should be sent by one method only. Comments may be inspected at FinCEN between 10 a.m. and 4 p.m., in the FinCEN Reading Room in Washington, D.C. People wishing to inspect the comments submitted must request an appointment by telephoning (202) 354-6400 (not a toll-free number).

FOR FURTHER INFORMATION CONTACT: Office of Chief Counsel, FinCEN, (703) 905-3590; Office of the General Counsel (Treasury), (202) 622-1927; or the Office of the Assistant General Counsel for Banking and Finance (Treasury), (202) 622-0480 (not toll-free numbers).

SUPPLEMENTARY INFORMATION

I. Background

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act) Act of 2001 (Public Law 107-56) (“the Act”). Title III of the Act, also known as the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, made a number of amendments to the anti-money laundering provisions of the Bank Secrecy Act (“BSA”), which are codified in subchapter II of chapter 53 of title 31, United States Code. These amendments are intended to make it easier to prevent, detect, and prosecute international money laundering and the financing of terrorism.

Section 352(a) of the Act, which became effective on April 24, 2002, amended section 5318(h) of the BSA. As amended, section 5318(h)(1) requires every financial institution, including persons involved in real estate settlements and closings under section 5312(a)(1)(U), to establish an anti-money laundering program that includes, at a

minimum: (i) the development of internal policies, procedures, and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test programs. When prescribing minimum standards for anti-money laundering programs, section 352 directs the Secretary of the Treasury to “consider the extent to which the requirements imposed under [section 352 of the Act] are commensurate with the size, location, and activities of the financial institutions to which such regulations apply.” The Secretary has delegated the authority to administer the BSA to the Director of FinCEN.

On April 29, 2002, and again on November 6, 2002, FinCEN temporarily exempted certain financial institutions, including persons involved in real estate closings and settlements, from the requirement to establish an anti-money laundering program.¹ The purpose of the temporary exemption was to enable Treasury and FinCEN to study the affected industries and to consider the extent to which anti-money laundering program requirements should be applied to them, taking into account the specific characteristics of the various entities defined as “financial institutions” by the BSA.

A real estate closing or settlement is the process in which the purchase price is paid to the seller and title is transferred to the buyer.² The process may be carried out in different ways, depending on a number of factors, including location. In the eastern states, typically the parties meet and exchange documents in what is sometimes referred to as a “New York style” or “table closing.” In the western states, the parties may not meet, instead relying on the services on an escrow agent to handle the documents in what

¹ See 31 CFR 103.170, as codified by interim final rule published at 67 FR 21110 (April 29, 2002, as amended at 67 FR 67547 (November 6, 2002) and corrected at 67 FR 68935 (November 14, 2002).

is sometimes referred to as a “Western style” or an “escrow closing.”³ The person actually conducting the process may be an attorney, a title insurance company, an escrow company, or another party.

II. Issues for Comment

1. What are the money laundering risks in real estate closings and settlements?

The real estate industry could be vulnerable at all stages of the money laundering process by virtue of dealing with high value products.⁴ Money launderers have used real estate transactions to attempt to disguise the illegal source of their proceeds. For example, narcotics traffickers have purchased property with monetary instruments that they purchased in structured amounts (that is, multiple purchases each below the BSA reporting thresholds that in aggregate exceeded the thresholds).⁵ Narcotics traffickers have also tried to launder cash proceeds by exchanging them for checks from a real estate company.⁶

In money laundering, the initial or placement stage is the stage at which funds from illegal activity, or funds intended to support illegal activity, are first introduced into the financial system. This could occur, for example, in the real estate industry through the payment for real estate with a large cash down payment.

In the second or layering stage of money laundering, the illicit funds are further disguised and distanced from their illegal source through the use of a series of frequently

² Whether the process is referred to as a settlement or a closing may vary by jurisdiction. See, e.g., 24 CFR 3500.2 explaining that settlement for purposes of the Real Estate Settlement Procedures Act of 1974 (“RESPA”) may also be called a “closing” depending on the jurisdiction.

³ See, 11 Thompson on Real Property, sec. 94.04.

⁴ According to a report published by the National Institute of Justice, “real estate transactions offer excellent money laundering opportunities,” and, in particular, opportunities to “legitimate and repatriate illegal funds.” Barbara Webster and Michael S. McCampbell, National Institute of Justice, International Money Laundering: Research and Investigation Join Forces, September 1996, pages 5 and 6.

⁵ See, e.g., U.S. v. High, 117 F.3d 464 (11th Cir. 1997).

complex financial transactions. This could occur in the real estate industry when, for instance, multiple pieces of real estate are bought and resold, exchanged, swapped, or syndicated, making it more difficult to trace the true origin of the funds.⁷

The third or integration phase of money laundering occurs when the illegal funds appear to have been derived from a legitimate source. In the context of the real estate industry, this could occur when real estate is sold by a money launderer to a bona fide purchaser and the purchaser, or his or her financial institution, provides the money launderer with a check that the money launderer then has the ability to represent as the proceeds of a legitimate business transaction.

The real estate industry itself has taken steps to identify potential money laundering vulnerabilities. For instance, the American Land Title Association has identified several potential “red flag” situations involving real estate transactions, including:

- Where a prospective buyer is paying for real estate with funds from a high risk country, such as a “non-cooperative country or territory” as designated by the Financial Action Task Force (“FATF”) or a country designated by the Secretary as “a primary money laundering concern” pursuant to Section 311 of the Act;
- Where the seller requests that the proceeds of a sale of real estate be sent to a high risk country;
- Where a person is seeking to purchase real estate in the name of a nominee and has no apparent legitimate explanation for the use of a nominee;

⁶ See U.S. v. Leslie, 103 F.3d 1093 (2d Cir. 1997).

- Where a person is acting, or appears to be acting, as an agent for an undisclosed party and is reluctant or unwilling to provide information about the party or the reason for the agency relationship;
- Where a person does not appear to be sufficiently knowledgeable about the purpose or use of the real estate being purchased;
- Where the person appears to be buying and selling the same piece of real estate within a short period of time or is buying multiple pieces of real estate for no apparent legitimate purpose;
- Where the prospective purchaser or seller seeks to have the documents reflect something other than the true nature of the transaction; and
- Where the person provides suspicious documentation to verify his or her identity.

FinCEN solicits comment on the experience of the real estate settlement industry with money laundering schemes, the existence of any safeguards in the industry to guard against money laundering, and what additional steps may be necessary to protect the industry from abuse by money launderers, including those who finance terrorist activity.

2. How should persons involved in real estate closings and settlements be defined?

The BSA identifies a person involved in a real estate closing or settlement as a financial institution. The statute includes no definition of the term and FinCEN has not had an occasion to define the term in a regulation. Moreover, the legislative history provides no insight into how Congress intended the term to be defined. Because section

⁷ See U.S. v. Nattier, 127 F.3d 655 (8th Cir. 1997) (embezzler engaged in a number of real estate purchases

5312(a)(1)(U) uses the phrase “persons involved in real estate closings and settlements” (emphasis added), a reasonable interpretation of the section could therefore cover participants other than those who actually conduct the real estate settlement or closing.⁸

The universe of participants in real estate transactions is potentially broad, even in the simplest residential real estate transaction. The typical residential real estate transaction may involve the following participants:

- A real estate broker or brokers,
- One or more attorneys, who represent the purchaser or the seller,
- A bank, mortgage broker, or other financing entity,
- A title insurance company,
- An escrow agent, and
- An appraiser, who may assess the condition and value of the real estate, as well as various inspectors.

Moreover, the participants involved, and the nature of their involvement, could vary with the contemplated use of the real estate, the nature of the rights to be acquired, or how these rights are to be held. Real estate may be acquired for any one or number of purposes, including, without limitation, residential, commercial, portfolio investment, or development purposes. As for the nature of the rights to be acquired, the real estate may be held in fee simple, under a lease agreement or as security for indebtedness. Finally, real estate may be held directly or through various investment vehicles, such as real estate investment trusts, real estate limited partnerships, or entities commonly referred to as “syndicates” of real estate investors.

through real estate firm in an attempt to conceal the source of the funds).

The guiding principle in defining the phrase “persons involved in real estate closings and settlement” is to include those persons whose services rendered or products offered in connection with a real estate closing or settlement that can be abused by money launderers. Equally as important is identifying those persons who are positioned to identify the purpose and nature of the transaction. Another factor may be the importance of various participants to successful completion of the transaction, which may suggest that they are well positioned to identify suspicious conduct. In addition, professionals may have very different roles, in different transactions, that greatly impact on their exposure to money laundering. At one end of the spectrum may be those professionals involved in structuring a real estate deal (and thus in the best position to observe and prevent their use for money laundering); at the other end, those whose role may be far from the financial aspects, such as property inspectors. Finally, involvement with the actual flow of funds used to purchase the property is a significant factor.

As noted above, attorneys often play a key role in real estate closings and settlements and thus merit consideration along with all the other professionals involved in the closing and settlement process. Section 352 requires that a financial institution take steps to detect and prevent itself from being abused by money launderers, and to comply with existing BSA requirements, such as reporting the receipt of cash or cash equivalents in an amount over \$10,000 on Form 8300. This provision does not independently impose any reporting requirements on financial institutions. FinCEN therefore does not believe that application of section 352 requirements to attorneys in connection with activities relating to real estate closings or settlements raises issues of, or poses obligations

⁸ Thus, for example, in a settlement or closing involving residential property, the term could cover participants other than the settlement agent listed on the HUD-1 form, as required by RESPA.

inconsistent with, the attorney-client privilege.⁹ In fact, attorneys already must exercise due diligence when they receive funds from clients where there is an indication that the funds may be tainted, and cannot simply accept funds without the risk that their fees will be subject to forfeiture.¹⁰ When engaging in conduct subject to anti-money laundering regulations, attorneys, like other professionals, should take the basic steps contemplated by section 352 to ensure that their services are not being abused by money launderers.

FinCEN accordingly seeks comment on which participants in the real estate closing or settlement process are in a position where they can effectively identify and guard against money laundering in such transactions. Information and comment may, among other things, address both the extent to which various participants have access to information regarding the nature and purpose of the transactions at issue and the importance of the participants' involvement to successful completion of the transactions. Information and comment should focus on the real estate sector in general and on various transaction types. FinCEN is particularly interested in receiving comments addressing commercial real estate transactions. Comments are welcome from those involved centrally in the real estate settlement process, i.e., those who may act as an agent for all parties and are responsible for reviewing the form and type of payment, as well as being aware of the parties to the real estate transaction, and those who view their involvement as more peripheral.

⁹ The recent resolution by the American Bar Association opposing the imposition of suspicious activity reporting obligations on attorneys recognizes the distinction between anti-money programs and reporting requirements. See Task Force on Gatekeeper Regulation and the Profession, Report to the House of Delegates (available on www.abanet.org/leadership/recommendations03/104.pdf) (accepting the concepts of reasonable compliance training and due diligence to minimize risk of lawyers' involvement in illegal money laundering activity).

¹⁰ See *U.S. v. Moffitt, Zwierling & Kemler, P.C.*, 83 F.3d 660 (4th Cir. 1996) (firm that "tiptoed" around the most pertinent questions regarding the source of fees received from drug dealer required to forfeit fees shown to be derived from proceeds of narcotics trafficking).

3. Should any persons involved in real estate closings or settlements be exempted from coverage under section 352?

FinCEN also solicits comments regarding whether there should be an exemption for any category of persons involved in real estate closings and settlements. In this connection, FinCEN anticipates that persons that are already subject to separate anti-money laundering program rules (or that will be subject to separate rules) will not also be subject to the anti-money laundering rules for persons involved in real estate closings and settlements.¹¹ Comments regarding possible exemptions should be designed to enable FinCEN to evaluate whether the risk of money laundering through a category of persons is sufficiently small that a proposed anti-money laundering program rule could be crafted that would exempt the category while also providing adequate protection for the industry from the risks of money laundering. In addition, FinCEN wishes to make it clear that it does not intend to cover purchasers and sellers of their own real estate, although they, too, are “persons involved in real estate settlements and closings.” The question of exemption is specifically directed to real estate professionals, and those who trade in real estate on a commercial basis.

4. How should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?

In applying section 352 of the Act to persons involved in real estate closings and settlements, FinCEN must consider the extent to which the standards for anti-money laundering programs are commensurate with the size, location, and activities of persons in this industry. FinCEN recognizes that while large businesses are involved in real

estate closings and settlements, businesses in this industry may be smaller companies or sole proprietors. FinCEN thus seeks comment on any particular concerns these smaller businesses may have regarding the implementation of an anti-money laundering program.

FinCEN also recognizes that persons involved in real estate closings and settlements may have some programs in place to meet existing legal obligations, such as the requirement to report on Form 8300 the receipt of over \$10,000 in currency and certain monetary instruments. These businesses may also have procedures in place to protect them against fraud. FinCEN therefore seeks comment on what types of programs persons involved in real estate closings and settlements have in place to prevent fraud and illegal activities, and the applicability of such programs to the prevention of money laundering.

III. Conclusion

With this ANPRM, FinCEN is seeking input to assist it in determining how to implement the requirements of section 352 with respect to persons involved in real estate closings and settlements. FinCEN welcomes comments on all aspects of a potential regulation and encourages all interested parties to provide their views.

IV. EXECUTIVE ORDER 12866

This ANPRM is not a “significant regulatory action” for purposes of Executive Order 12866. It neither establishes nor proposes any regulatory requirements. Instead, it seeks public comment on a wide range of questions concerning the extent to which the

¹¹ For example, banks already must comply with anti-money laundering rules. See 31 CFR 103.120. Similarly, loan and finance companies fall within the definition of a financial institution under the BSA, and are currently being studied by FinCEN for inclusion in the anti-money laundering rules.

anti-money laundering program mandates of section 352 of the USA PATRIOT Act should apply to persons involved in real estate closings and settlements.

Dated: _____

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