

Treasury to Issue Rules Under the USA PATRIOT Act Requiring Persons Involved in Real Estate Closings and Settlements to Establish Anti-Money Laundering Programs

In October 2001, President Bush signed into law the USA PATRIOT Act (the "Act"), which expanded the scope of national security laws and provided law enforcement with extensive new powers in the fight against terrorism. Section 352 of the Act, which became effective April 24, 2002, requires every "financial institution" to establish an anti-money laundering program. While those involved in certain real estate transactions are specifically covered by the definition of "financial institution," the Treasury temporarily exempted persons involved in real estate closings and settlements from compliance on November 6, 2002. However, on April 10, 2003, the Treasury issued an *Advanced Notice of Proposed Rulemaking*, intended to alert those in the real estate industry that this exemption will soon be lifted. *This means that persons and entities involved in real estate closings and settlements likely will need to comply with federal regulations for anti-money laundering programs in the near future.*

As has been shown by the recent implementation of USA PATRIOT Act regulations in industries such as securities, precious metals, credit cards and life insurance, the Treasury likely will move quickly from this point forward to enact regulations concerning the establishment of anti-money laundering programs in the real estate industry and to require compliance with these regulations. It is important for all those involved in any way with real estate closings and settlements to consider both: (1) what objections to the scope of coverage under Section 352 you might want to

lodge with the Treasury at this stage of regulatory activity; and (2) what you will need to do to comply with the new regulations if they are promulgated.

The following is a summary of the comments requested by the Treasury, to which you should consider responding, and an explanation of what compliance will likely mean for those covered by the new regulations.

I. Comments Requested

In its Advanced Notice of Proposed Rulemaking, the Treasury has requested comments on the following issues:

1. **What are the money laundering risks in real estate closings and settlements?**
2. **How should persons involved in real estate closings and settlements be defined?**
3. **Should any persons involved in real estate closings or settlements be exempted from coverage under section 352?**
4. **How should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?**

From the Advanced Notice of Proposed Rulemaking, the Treasury believes that money laundering *does occur* within the current system of real estate closings and settlements.

Therefore, although the Treasury would like concrete examples to pinpoint specific money laundering risks, the key issue now driving the Treasury is who should be covered. On this point, several comments are in order:

- The Treasury lists the following entities as likely participants in a typical residential real estate transaction:
 - 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, as well as various inspectors.

While the above list reveals entities the Treasury is currently considering for coverage, it is neither comprehensive nor final. Traditionally, in determining responsibility for anti-money laundering programs, the Treasury will ask the following two questions:

- **Who is in the best position to know when money laundering is occurring?, and**
- **Who is in the best position to implement a compliance program designed to report evidence of possible money laundering?**

From the Treasury's comments, it appears that coverage will focus on **commercial transactions**. Therefore, the biggest burden of compliance will likely center on those involved in commercial real estate deals where the Treasury sees the opportunity for laundering large sums of money. Coverage may also include real estate brokers and agents, as

entities involved in the sale and documentation of the sale of real estate. In addition, attorneys working on deals, even if not present at closing, may be subject to coverage. This could mean that an in-house counsel is required to comply with PATRIOT Act regulations separate from his or her employer.

- Although compliance may focus on the "big players," the specific **exemptions** identified by the Treasury are currently very limited:
 - Entities such as banks, loan and finance companies, who are already subject to separate anti-money laundering program rules, and
 - Individual homeowners engaged in residential transactions.

Therefore, any individuals or entities who do not fall under either of these exemptions should assume that they are meant to be covered by the new regulations.

If you believe that your company should be exempt from these new regulations, **you are encouraged to comment** on this issue. The comment period gives the industry the ability to effect change in the scope and impact of the eventual regulations. For example, in the insurance industry, insurance brokers and agents to date have been exempted from the proposed PATRIOT Act regulations as a result of heavy lobbying.

- In addition, those companies who clearly appear to be covered by the new regulations, such as title companies, should consider the business ramifications of compliance in responding to the issue of how the anti-money laundering program requirement should be structured.

✓ Comments on all topics may be submitted by electronic mail sent to regcomments@fincen.treas.gov or by paper mail to FinCEN, P.O. Box 39, Vienna, VA 22183-0039, with the caption “ATTN: Section 352 – Real estate settlements.” All comments must be submitted by June 9, 2003.

II. What Compliance Will Mean

The purpose of this new legislation is to integrate the real estate industry with the other industries currently subject to PATRIOT Act coverage as part of a nationwide scheme to detect fraud by finding and tracing the proceeds of illegally obtained funds. This fraud detection is accomplished through the reporting of suspicious transactions by each industry. The establishment of anti-money laundering programs is viewed as necessary to ensure that those responsible for filing reports of suspicious transactions have the knowledge and training to do their jobs effectively. To this end, the following will occur within the real estate industry if final regulations are enacted:

- Those included in the definition of “persons involved in real estate closings and settlements” will be required to **create federally-compliant anti-money**

laundering programs. At a minimum, these programs will need to include:

- ✓ The development of internal policies, procedures and controls;
- ✓ Designation of a compliance officer;
- ✓ An ongoing employee training program; and
- ✓ Establishment of an independent audit of the program.

Compliance programs will likely not be identical, but will be required to be tailored to the size, location and activities of each entity involved in real estate closings and settlements. If the regulations follow the model proposed for the insurance industry, each real estate entity will need to perform a risk assessment to determine the proper scope of the procedures and training necessary for compliance with the new regulations.

- **Time and Costs:** Compliance with the PATRIOT Act will come with a price tag. Building and maintaining the administrative systems necessary for the development of a compliant program and adequately training employees will require significant manpower and expense. This makes pre-planning for these regulations very important.

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