Bloomberg
CORPORATE LAW JOURNAL

Volume 2 Fall 2007 Issue 4

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Reprinted from
Bloomberg
CORPORATE LAW JOURNAL
Volume 2, Fall 2007, Issue 4

RECENT DEVELOPMENTS IN ANTI-MONEY LAUNDERING AND ANTI-TERRORISM FINANCING AND THE EFFORT TO REGULATE PERSONS INVOLVED IN REAL ESTATE CLOSINGS AND SETTLEMENTS

By Norma J. Williams

Introduction

On September 23, 2001, in response to the September 11, 2001 attacks on the United States, President Bush signed Executive Order 13224 (Executive Order).[1] Forty-five days after the attacks, Congress passed the "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act" (commonly known as the USA PATRIOT Act, and referred to in this article as the "Act" or the "Patriot Act").[2] Both measures, in different ways, were designed to limit the extent to which attacks such as those that occurred on September 11, 2001 could occur in the future. The measures have been the subject of extensive scholarship. Recent developments demonstrate that there is still substantial activity in connection with the Executive Order and the Act. There has also been significant activity in connection with the Gatekeeper Initiative established by national and international efforts in order to consider the anti-money laundering obligations of professionals, including attorneys. The purpose of this article is to review current developments with respect to the measures, and provisions of each that are relevant to those developments.

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1. Exec. Order No. 13,224, 66 Fed. Reg. 49,079 (Sept. 25, 2001).

2. Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

General Background

A. Patriot Act

The purposes of the Patriot Act, as stated in the legislation, were "(t)o deter and punish (domestic and foreign) terrorist acts. . .(and) to enhance law enforcement investigatory tools."[3] The Act intended to accomplish this by imposing new and/or enhanced monitoring, reporting, record keeping and due diligence requirements on financial institutions.

Anti-Money Laundering Provisions

One of the main objectives of the Patriot Act was to prevent money laundering, since Congress perceived that money laundering was the primary tool used by terrorists to accomplish their goals. The Act did this by amending and strengthening the anti-money laundering provisions of the Bank Secrecy Act of 1970 (BSA), which had imposed an obligation on sixteen categories of traditional financial institutions, such as insured banks, to establish anti-money laundering (AML) programs, based on concerns at that time that foreign banks were laundering the proceeds of illegal activity and evading federal income taxes.[4] In 1988, the BSA was amended to include six additional categories of financial institutions (including "persons involved in real estate closings and settlements") in an apparent effort to address money laundering in connection with illicit drug activities.[5] In 1994, the BSA was amended to add casinos and certain gambling establishments.[6] As a result of the Patriot Act amendments to the BSA, the total number of financial institutions was increased to twenty-seven.[7]

Section 352 of the Patriot Act further amended the BSA by (a) requiring all those financial institutions to establish an AML program within a statutorily mandated period of time (which date was extended for certain financial institutions); and (b) setting forth the required areas that must be covered in such a program.[8]

Administration of the Bank Secrecy Act and the Patriot Act

The Treasury Department, in 1990, delegated the authority to administer the BSA to the Director of the Department's Financial Crimes

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3. *Id.*

4. *See generally* Peter E. Meltzer, *Keeping Drug Money from Reaching the Wash Cycle: A Guide to the Bank Secrecy Act*, 108 Banking L.J. 230 (1991).

5. Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690 §§ 6181, 6185, 102 Stat. 4354 (codified as amended at 31 U.S.C. § 5312(a)(2) (1988)).

6. Money Laundering Suppression Act of 1994, Pub. L. No. 103-325, 108 Stat. 2252 (codified as amended at 31 U.S.C. § 5312(A)(2)(X)(2003)).

7. 31 U.S.C § 5312(a)(2) and § 5312(c)(1) (2003).

8. *See* USA Patriot Act § 352(b), 115 Stat. 272, 322 (codified at 31 U.S.C. § 5318(h) (2003)); 31 C.F.R. § 103.170 (2004).

Enforcement Network (FinCEN). Because the Patriot Act amends the BSA, this agency administers the Act for the Treasury Department as well.

Information-Sharing with the Government

Pursuant to the final rule issued by FinCEN under Section 314 of the Patriot Act[9] (Section 314 Final Rule), financial institutions are required to search their records and identify accounts of, or transactions with, individuals or entities that have been certified as, or reasonably suspected of, engaging in money laundering or terrorist activities. The records subject to inspection under the Section 314 Final Rule are not limited to the financial institutions' customers or clients; the language of the rule includes employees as well as those entities with which the financial institution does business.

The information sharing is a two-way street; the federal government also shares information with financial institutions. An October 23, 2007 Fact Sheet issued by FinCEN identified the extent of this information-sharing.[10]

Regulations relating to the mutual information sharing are set forth in 31 C.F.R. §103.90 *et seq.*

Customer Identification Programs

The Patriot Act requires financial institutions to adopt programs to verify customer identity.[11] At a minimum, the customer identification program must enable a financial institution to verify the identities of individuals opening accounts, maintain records of the information used to verify identity and consult lists provided by the government to determine whether the customer is a known or suspected terrorist.

Suspicious Activity Reporting

Although banks were already required to file suspicious activity reports under the BSA, the Patriot Act extended this requirement to all financial institutions. Title 31 of the Code of Federal Regulations sets forth the suspicious activity reporting requirements of the different financial institutions. Banks, for example, must file such a report if a transaction involves funds in an amount of at least $5,000 and the bank suspects that the transaction involves funds derived from an illegal source, is designed to avoid the BSA or has no apparent business purpose. The report

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9. Financial Crimes Enforcement Network; Special Information Sharing Procedures To Deter Money Laundering and Terrorist Activity, 67 Fed. Reg. 60,562, 60,579 (September 26, 2002) (codified at 31 C.F.R. pt. 103, *available at* http://www.fincen.gov/section314finalrule.pdf).

10. Financial Crimes Enforcement Network, U.S. Department of the Treasury, FinCEN's 314(a) Fact Sheet (2007), http://www.fincen.gov/314afactsheet.pdf.

11. USA Patriot Act, § 326. Title 31 of the Code of Federal Regulations also sets forth regulations for the Customer Identification Programs of financial institutions.

has to be filed within thirty days of the detected suspicious activity. The bank cannot notify anyone involved in the transaction that the report was filed (the so-called "no tipping off" rule), and the law provides the bank with a safe harbor from liability for disclosing information through a suspicious activity report.[12]

Due Diligence Requirements

Banks and other financial institutions must comply with special due diligence requirements when establishing, administering or managing either a private banking account or a correspondent account in the United States for a non-U.S. person[13]

Correspondent Accounts

The Act prohibits certain "covered institutions"[14] from maintaining correspondent accounts for foreign shell banks.[15]

Penalties under the Patriot Act

The penalty provisions of the Patriot Act are contained in 31 U.S.C. §§ 5321 (civil) and 5322 (criminal). The penalties for violation of the Patriot Act are extensive and are based on the provision violated.

Civil penalties for violations can range from $25,000 to $100,000 per violation. Furthermore, a separate violation occurs for each day the violation continues and at each office, branch or place of business a violation occurs or continues. Both intentional and negligent violations of the BSA are punishable by fines.

Criminal penalties for institutions including freezing of assets and up to $1,000,000 in fines. Individuals can be fined up to $500,000 and face up to ten years' imprisonment. As with the civil penalties, a separate violation occurs for each day the violation continues and at each office, branch or place of business a violation occurs or continues.

B. Executive Order 13224

Another measure put in place in response to the September 11, 2001 attacks was Executive Order 13224,[16] signed by President Bush on September 23, 2001. This measure then, preceded the USA Patriot Act and is

12. 31 C.F.R. § 103.18 (2007).

13. 31 C.F.R. §§ 103.175-103.176, 103.178 (2007). A non-U.S. person is defined in 31 C.F.R. § 103.175(j) (2007).

14. Insured bank, commercial bank or trust company, private banker, agency or branch of a foreign bank in the US, credit union, savings association and a broker or dealer registered with the SEC under the Securities and Exchange Act of 1934 and other categories under 31 C.F.R. § 103.175.

15. 31 C.F.R. § 103.77 (2007).

16. A copy of the Executive Order can be found at http://www.treas.gov/offices/enforcement/ofac/ legal/eo/ 13224. pdf.

different from it. The Executive Order was designed to bar transactions with known terrorists and terrorist organizations (prohibited persons) in order to combat the financing of terrorism.

Doing Business Prohibitions

The Executive Order mandated that no U.S. company may do business with any person whom the Order prohibits, including persons who have committed, or pose a risk of committing or supporting, terrorist acts, and specifically those identified on the SDN List. The SDN List is maintained by the Treasury Department's Office of Foreign Assets Control (OFAC).[17]

Applicability to All U.S. Businesses and Persons

Unlike the Patriot Act that applies only to financial institutions, as defined, the Executive Order applies to all U.S. businesses and persons. As such, the obligations are not related to the AML programs, which apply only to financial institutions pursuant to the Patriot Act.

The Executive Order outlines a number of prohibited transactions. These include:

- Any transaction or dealing by a "United States person,"[18] or within the U.S., in property or interests that are blocked by the Executive Order;
- Any donation by a United States person to any person or entity listed by the Executive Order;
- Any association or support with any person or entity on the list.

Penalties under the Executive Order

Penalties for violations of the Order can be substantial. Depending on the program, criminal penalties can include fines ranging from $50,000 to $10,000,000, and imprisonment ranging from ten to thirty years for willful violations. Depending on the program, civil penalties range from $11,000 to $1,000,000 for each violation.[19] All violators can have their assets frozen or forfeited.

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17. An updated OFAC List can be obtained at the U.S. Department of Treasury website at ttp://www.ustreas.gov/ofac.

18. Section 3 of the Executive Order provides that persons are an individuals, partnerships, associations, corporation, organization, group or subgroup and a U.S. person includes any citizen, permanent resident alien, entity organized under the laws of the United States (including foreign branches) and any person in the United States.

19. Information about the penalties can be obtained from the U.S. Treasury Department website at http://www.ustreas.gov/offices/enforcement/ofac/faq/answer.shtml#11 (last visited October 26, 2007).

C. International Initiatives; the ABA Gatekeeper Taskforce

In 1989, the Financial Action Task Force (FATF) was established at the G-7 Summit in Paris. The mission was to fight money laundering activities worldwide on an international basis. The organization has no legal standing, so its pronouncements and opinions are not binding. Countries are designated as either "cooperative" or "non-cooperative" based on their compliance with the FATF recommendations. The U.S. participates as a cooperative nation and The International Monetary Fund and the World Bank use the recommendations of FATF in connection with their anti-money laundering activities.

FATF promulgated its "Forty Recommendations"[20] for governments, financial institutions and non-financial businesses and professions. They have been revised several times, most recently in 2003. In October 2001, FATF also issued nine Special Recommendations on Terrorist Financing[21] to be implemented around the world. Among the FATF recommendations was a recommendation whereby certain professionals, including lawyers, who are involved in assisting clients in transactions and business dealings are urged to report suspicious transactions when they engage on behalf of a client, except where they are subject to professional secrecy or legal professional privilege.

An adjunct to the development of the Forty Recommendations is the "Gatekeeper Initiative." That initiative, which had its genesis in the Ministerial Conference of the G-8 Countries on Combating Transnational Organized Crime held October 19-20, 1999 in Moscow,[22] sought to have the G-8 countries make their anti-money laundering regimes more compatible and to consider putting responsibility on professionals such as lawyers, accountants, auditors and other financial intermediaries who could either block or facilitate the entry of organized crime money into the financial system. Because of the reach of the Gatekeeper Initiative and in order to enable the ABA to have a meaningful role in advising federal policymakers about anti-money laundering proposals, on February 1, 2002, Robert Hirshon, President of the American Bar Association established the ABA Task Force on Gatekeeper Regulation and the Profession.[23] The ABA Task Force noted that many of the Forty Recommendations may be applicable to lawyers. As set forth below, FATF is currently

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20. The Forty Recommendations can be found at http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF.

21. Found at http://www.fatfgafi.org/document/9/0,3343,en_32250379_32236920_34032073_1_1_1_1,00.html.

22. The Moscow Communique, as it is called, is available at www.library.utoronto.ca/g7/adhoc/crime99.htm.

23. See American Bar Association (ABA) Task Force on Gatekeeper Regulation and the Profession, Comments of the ABA Task Force on Gatekeeper Regulation and the Profession on the Financial Action Task Force (FATF) Consultation Paper, May 30, 2002, http://www.abanet.org/crimjust/taskforce/actions/gatekeeper.pdf.

involved in the effort to have AML requirements imposed on American lawyers.

New Developments

A. Adoption of Money Laundering Regulations Governing Financial Institutions

2007 Updates

(a) Regulations setting forth the AML requirements for the money laundering programs for a number of financial institutions defined under the Act have been issued. Regulations have not been adopted for "persons involved in real estate closings and settlements."
(b) In June, 2007, FinCEN announced an initiative to make regulations under the BSA more "intuitive" and to impose obligations that are more-risk-based.
(c) In May, 2007, FinCEN released its 2007 National Money Laundering Strategy.

Background

As set forth above, Section 352 of the Act (31 U.S.C. § 5318(h)) required all financial institutions to establish an AML program. The Act required that the AML programs includes four elements: (i) the development of written policies, procedures and controls; (ii) the designation of a program compliance officer; (iii) the creation of an ongoing employee training program; (iv) and the establishment of an independent audit function to test the effectiveness of the program.

Discussion of New Developments

The Department of the Treasury has adopted regulations pursuant to the Patriot Act amendments to the BSA as follows, which regulations are set forth at 31 C.F.R. § 103.120-103.185 (as revised as of 7-1-07 for the print version of the Code of Federal Regulations, and as of 8-9-07 for the online version of the Federal Register):

31 U.S.C. § 5312 Subsection (a)(2)	**Location of Regulations (31 C.F.R.)**	**Date of Issuance**
(A) insured bank	§ 103.120	4-29-02,[24] as amended 1-4-06

24. Guidance regarding the financial institutions affected by the regulations adopted on 4-29-02 can be found in the Federal Register discussion of same located at 67 Fed. Reg. 21109-21113 (April 29, 2002), 67 Fed. 67 Fed. Reg. 21117-21121 (April 29, 2002) and 67 Fed. Reg. 21121-21127 (April 29, 2002).

(B) commercial bank or trust company	§ 103.120	Same
(C) private banker	Temporarily exempted under §103.170[25]	4-29-02, as amended 11-6-02 and 11-14-02
(D) agency or branch of foreign bank	§ 103.120	4-29-02, as amended 1-4-06
(E) credit union	§ 103.120	Same
(F) thrift institution	§ 103.120	Same
(G) broker or dealer registered with the SEC under 1934 Act	§ 103.120	Same
(H) broker or dealer in securities or commodities[26]	§ 103.120	Same
(I) Investment banker[27]	§ 103.120	Same
(I) Investment company	(a) Open-end mutual companies: § 103.130 (b) Other Investment Companies: temporarily exempted under §103.170	4-29-02 4-29-02, as amended 9-26-02
(J) currency exchange	§ 103.125 (entity defined under §103.11(uu)(1))	4-29-02

25. This chart identifies a number of financial institutions that were temporarily exempted as of April 29, 2002 and remain so and several that were originally temporarily exempted but for which regulations were later issued. Other than with respect to the category of "persons involved in real estate closings and settlements," this article does not discuss studies, proposed rules, comments or any other activity with respect to the institutions that were temporarily exempted and remain so. However, it is noted that some such activity has occurred and persons potentially affected by the adoption of regulations may wish to consider the activity that has occurred in an attempt to establish AML regulations for that category of financial institution.

26. Fn. 5 of discussion beginning at 67 Fed. Reg. 211109 (April 29, 2002) indicates that this category includes "introducing brokers."

27. The discussion at 67 Fed. Reg. 21112 (April 29, 2002) indicates that investment bankers in subsection (I) were not excluded because "all such entities are either depository institutions or securities broker-dealers that are subject to anti-money laundering program requirements by section 103.120(b) or (c), respectively."

(K) issuer, etc. of travelers check, checks, money orders, or similar	§ 103.125 (entity defined under § 103.11(uu)(3))	4-29-02
(L) operator of credit card system	§ 103.135	4-29-02
(M) insurance company	§ 103.137 (Originally temporarily exempted under § 103.170)	11-3-05 4-29-02, as amended 11-6-02 and 11-14-02
(N) dealer in precious metals, stones or jewels	§ 103.140 Originally temporarily exempted under §103.170)	6-9-05 4-29-02, as amended 11-6-02 and 11-14-02
(O) pawnbroker	Temporarily exempted under § 103.170	4-29-02, as amended 11-6-02 and 11-14-02
(P) loan or finance company	Same	Same
(Q) travel agency	Same	Same
(R) licensed transmitter of funds	§ 103.125 (entity defined under § 103.11(uu)(5))	4-29-02
(S) telegraph company	Temporarily exempted under § 103.170	4-29-02, as amended 11-6-02 and 11-14-02
(T) vehicle salesperson	Same	Same
(U) persons involved in real estate closings and settlements	Same; Advance Notice of Proposed Rulemaking issued 4-10-03	Same
(V) US Postal Service	§ 103.125 (defined as a money services business under § 103.11(uu (6))	4-29-02
(W) US govt. agency carrying out business described in Section 5312(a)(2)	Temporarily exempted under § 103.170	4-29-02, as amended 11-6-02 and 11-14-02
(X) casino, other gaming establishment	§ 103.120 § 103.64	4-29-02 3-12-93, as amended 12-1-94, 6-29-95 and 9-26-02
(Y) businesses similar to above	N/A	N/A

(Z) any other business designated by Secretary of the Treasury	N/A	N/A

31 U.S.C. § 5312 Subsection (c)(1)	**Location of Regulations (31 C.F.R.)**	**Date of Issuance**
Futures commission merchant	§103.120	4-29-02, as amended 1-4-06
Commodity trading advisor	Temporarily exempted under § 103.170	4-29-02, as amended 11-6-02 and 11-14-02
Commodity pool operator	Same	Same

With respect to future regulations, FinCEN has stated that it is its intent to be more "intuitive" and "risk-based." On June 22, 2007, FinCEN issued its Bank Secrecy Act Effectiveness and Efficiency Fact Sheet.[28] In it, FinCEN indicated that it would begin work on its own separate chapter of the Code of Federal Regulations that would include, for each regulated industry, one general part and several specific subparts so that compliance officials in the industry would not have to sift through several parts and subparts of the Code of Federal Regulations to find all of the regulations applicable to it.

In that Fact Sheet, FinCEN also announced that, in keeping with its developing a risk-based approach to regulation, it would require that financial institutions and regulators treat compliance obligations in a manner that avoids expenditures that are not commensurate with actual risk. A discussion of risk-based approach in another context (attorneys, real estate closings and settlement) is discussed below.

While much of the effort with respect to money laundering has focused on eliminating terrorist financing, FinCEN has also recognized that money laundering presents risks apart from terrorist financing and has set forth a strategy to address money laundering in all of its guises. The 2007 National Money Laundering Strategy,[29] issued on May 3, 2007, stated, "while money launderers and terrorist financiers may use the same financial channels and employ similar techniques, there are differences in their operations and in our strategies against them."[30]

28. Found at http://www.fincen.gov/bsa_fact_sheet.pdf.

29. The 2007 National Money Laundering Strategy can be found at http://www.fincen.gov/nmls_2007.pdf.

30. *Id.* at v.

B. The Effort to Regulate Persons Involved in Real Estate Closings and Settlements (General)

2007 Updates

(a) To date, the Treasury Department has not issued regulations governing persons involved in real estate closings and settlements. The international community, through FATF has begun an inquiry into the extent to which a risk-based approach to anti-money laundering initiatives should be applicable to the private sector.

(b) In December, 2006, FinCEN issued a report entitled "Money Laundering in the Commercial Real Estate Industry: An Assessment Based Upon Suspicious Activity Report Filing Analysis."

Background

FinCEN, on April 10, 2003 issued an advance notice of proposed rulemaking (Advance Notice) in connection with the AML program requirements for the financial institution defined under 31 U.S.C. § 5312(a)(2)(U) as "persons involved in real estate closings and settlements." The Advance Notice requested input on four 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 requirements for persons involved in real estate closings and settlements be structured?

Items (1) and (2) are discussed below.

With regard to Item (1), the identification of risks, the Advance Notice identified hypothetical ways in which real estate activity could be involved in money laundering at the placement stage (when the funds are first introduced into the financial system), the layering stage (when the illicit funds are disguised and distanced from their illegal source through complex financial transactions) and the integration stage (when the funds are "laundered" and can be used by the criminal group that placed them in the system). The Notice also looked at three 1997 court decisions involving real estate in which the defendants voluntarily participated in criminal activity (as opposed to being unwitting facilitators of money laundering).

With respect to Item (2), the Advance Notice noted that the BSA did not have a definition of "persons involved in a real estate closing or settlement," that such had not been defined in any regulations and that there was no Congressional legislative history on the term. It also noted that since the word "involved" was used, the section could apply to partici-

pants other than those who actually conduct the real estate settlement or closing. The Advance Notice noted that the term "persons involved in real estate closings and settlements" might reasonably include 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 real estate, as well as various inspectors. These participants and the nature of their participation, could vary with the contemplated use of the real estate, the nature of the rights to be acquired or how the rights are to be held. The Advance Notice stated that the guiding principle for the definition should be to include "those persons whose services rendered or products offered in connection with a real estate closing or settlement can be abused by money launderers." It stated that other factors included looking at those who could identify the nature and purpose of the transaction, the importance of the participants to the successful completion of the transaction, involvement with the actual flow of the funds and the role played by the professional (e.g. structuring a deal versus those not involved in the financial structuring).

FinCEN reviewed fifty-two comment letters in response to the Advance Notice, twenty-four of which were from legal organizations.[31] Legal organizations that responded included the ABA Section of Real Property, Probate and Trust Law (now the Section of Real Property, Trust and Estate Law), American College of Real Estate Lawyers, ABA Task Force on Gatekeeper Regulation and the Profession, American College of Mortgage Attorneys, American Land Title Association, Real Property, Probate and Trust Law Section of the Florida State Bar Association and the National Association of Realtors. The letters of those legal organizations are set forth below.[32]

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31. All of the comments are available at http://www.fincen.gov/reg_352 comments.html.

32. These letters can be found as follows: American Bar Association (ABA), Section of Real Property, Probate and Trust Law, USA Patriot Act Task Force, *Advance Notice of Proposed Rulemaking for Persons Involved in Real Estate Closings and Settlements*, June 9, 2003, http://www.abanet.org/rppt/section_info/patriotact/abacommentletter6-03.pdf; American College of Real Estate Lawyers, USA Patriot Act Task Force, *Advance Notice of Proposed Rulemaking for Persons Involved in Real Estate Closings and Settlements,* June 9, 2003, http://www.acrel.org/Documents/PublicDocuments/FinCEN1Letter.pdf; ABA Task Force on Gatekeeper Regulation and the Profession, *Section 352 Real Estate Settlements*, June 9, 2003, http://www.abanet.org/crimjust/taskforce/actions/fincen.pdf; American College of Mortgage Attorneys (ACMA), *Proposed Rules Concerning Anti-Money Laundering Requirements for "Persons Involved in Real Estate Closings and Settlements,"* June 6, 2003, http://www.acmaatty.org/pdf/patriotletter.pdf; American Land Title Association, Section 352—Real Estate Settlements, 68 Fed. Reg. 17569, June 5, 2003 http://alta.org/govt/issues/03/c_68fr17569.pdf; Real Property, Probate and Trust Law Section of the Florida State Bar Association, *Comments of The Real Property, Probate and Trust Law Section of The Florida Bar in Response to Advance Notice of Proposed Rulemaking – Anti-Money Laundering Requirements for 31 Persons Involved in Real Estate Closings and Settlements*, June 9, 2003, http://www.abanet.org/crimjust/taskforce/actions/rpptl_comment.pdf; National Association of Realtors, *Section 352—Real Estate Settlements. Financial Crimes Enforcement Network: Anti-Money Laundering*

The two main themes in the responses were that (1) a cost-benefit analysis did not justify placing AML requirements on the real estate industry; and (2) with respect to attorneys, the AML requirements could adversely affect the attorney-client privilege and the duty of client confidentiality. More discussion of the concerns of attorneys is set forth below.

Discussion of New Developments

As set forth above, no regulations have been finalized or proposed for persons involved in real estate closings and settlements, in large part, it is believed, because of the concerns expressed by the legal community. The impetus to move this item forward may come from the international community, primarily from FATF.

In Fall 2007, FATF launched its Consultation with the Private Sector on the Risk-Based Approach (RBA) and identified its desire to have an increased dialog with the private sector (as opposed to financial institutions) to determine whether and how the private sector can be involved in the anti-money laundering efforts. A risk-based approach would seek to impose responsibilities on an industry based on the risk of money laundering potentially caused by its activities. The discussions to involve the private sector began in earnest following FATF's publication in July 2007 of its "Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing," which looked at the RBA in terms of the activities of countries and financial institutions. The private sector discussion therefore is about the extent to which an RBA should be developed in connection with the private sector (for whom it is discretionary), the extent to which the financial institutions sector RBA approach should be applied to the private sector and the cost/benefit of applying an RBA approach to the private sector. Discussion has also centered on who should develop the approach – the affected industries or some other entity (Treasury Department, FATF, etc.).

As of the date of this article, the latest series of meetings involving FATF and the representatives of various private sector industries (including but not limited to the real estate industry and attorneys) were held in September 2007 in London.

The discussions regarding lawyers and their involvement in the anti-money laundering efforts, including in connection with the discussions with FATF, is discussed below.

FinCEN Publication on Commercial Real Estate and Money Laundering

In December 2006, FinCEN issued a report "Money Laundering in the Commercial Real Estate Industry: An Assessment Based Upon Suspicious Activity Report Filing Analysis."

Program Requirements for "Persons Involved in Real Estate Closings and Settlements," June 11, 2003, http://www.abanet.org/crimjust/taskforce/actions/treasury.comment.pdf.

Much of the criticism of the effort to impose AML obligations on "persons involved in real estate closings and settlements" as financial institutions was the perception that the risk level posed by the real estate industry was small or not really known. The Advance Notice reliance on three cases where the real estate industry participants willingly involved in money laundering, it seemed, did not justify imposing the obligations on the entire industry.

In December 2006, FinCEN published a study of Suspicious Activity Reports (SARs) that had been filed with FinCEN over a ten year period.[33] In the Significant Findings, FinCEN found that a random sampling of the SARs describing commercial real estate transactions revealed that property management, real estate investment, realty (presumably brokerage) and real estate development companies were the most commonly reported entities associated with money laundering and related illicit activity. It found that professions that customarily collect fees in real estate transactions such as appraisers, inspectors, surveyors and attorneys, were reported as primary subjects with less frequency, and thus such entities were not listed in the tables published in the study.

Another Significant Finding was that since 2003, the trend line in suspicious activity reporting associated with potential commercial real estate related money laundering had risen steeply. The report stated that the increase was likely attributable to the steep decline in interest rate charges on real estate loans, which occurred contemporaneously with the increase in filings. The report questioned whether the trend would reverse as interest rates rose and real estate markets cooled.

Of the 9,528 SARs filed with FinCEN, the overwhelming majority (9,191) were filed by banks and other depository institutions, 271 were filed by securities and futures firms and sixty-six were filed by money service businesses. The report found that the SAR narratives fell into five categories: 1) structuring of deposits and withdrawals; 2) money laundering; 3) international transfers; 4) tax evasion and 5) miscellaneous illicit activity. The Report contains detailed information about the types of transactions that led to the filing of the SARs. The Report found that the top five businesses, professions and persons involved in activities that suggested money laundering, structuring and related illicit financial activity were, in order: 1) property management companies; 2) real estate investment companies; 3) individuals; 4) realty companies; and 5) real estate development companies.

It will be interesting to see the way in which the Report may be used to develop regulations for "persons involved in real estate closings and settlements," and whether the finding showing absence of reports regard-

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33. Financial Crimes Enforcement Network, U.S. Department of Treasury, *Money Laundering in the Commercial Real Estate Industry: An Assessment Based Upon Suspicious Activity Report Filing Analysis*, December 2006, http://www.fincen.gov/commercial_real_estate_assessment_final.pdf.

ing attorneys will lead to any diminished focus on attorneys (see however the next section).

C. The Effort to Regulate Attorneys as Persons Involved in Real Estate Closings and Settlements

2007 Updates

(a) As a part of the Gatekeeper Initiative, the effort to impose AML requirements on lawyers currently is currently looking at developing "best practices" guide.
(b) Discussions with the Treasury Department have included proposals to the effect that at least two American Bar Association Sections serve as prototypes for determining whether to impose a risk-based approach on American lawyers and, if so, to develop such an approach.

Background

As set forth above,[34] numerous legal organizations responded to the Advance Notice request for comments. To a large extent, these organizations were concerned with the effect of compliance with the requirements on the attorney-client privilege and the effect on the attorney's duty of confidentiality. The dialog arising out of the responses has also looked at what responsibility the AML responsibilities of lawyers should be, ranging from "no responsibility" to models described as follows:

(i) a best practices model which would require the development of educational programs on detecting and preventing money laundering activities, and to develop strategies to sensitize the settlement and closing community on money laundering and the guises that it takes. The fundamental premises of the best practices model is to ensure that persons who are not involved in an appreciable level of money laundering activity are not duped into being used in such schemes;
(ii) a financial intermediaries model which would regulate attorneys to the extent, but only to the extent, that they "touch the money;" i.e. physically handle the receipt and transmission of funds for a real estate closing and settlement;
(iii) a model which allow attorneys (and others in a transaction) to rely on the due diligence of others; i.e. permit the attorney to rely on due diligence performed by others as evidenced by a written confirmation of the same to the other parties to the transaction; and
(iv) a more generalized risk-based approach.

34. *See* list of responses at Endnote 19.

Whether or not attorneys should be subject to Suspicious Activity Reporting is also being debated.[35]

Discussion of New Developments

While no regulations have been issued under the Patriot Act regarding persons involved in real estate closings and settlements, the same types of issues have arisen under the Gatekeeper Initiative. American lawyers (as well as lawyers from other countries) have been at the table in the discussions with FATF on the application of AML obligations to the private sector and to legal professionals in particular.

As of the November, 2007 date of this article, the Treasury Department has expressed a willingness to work with the American Bar Association and other interested bar groups in the development of guidance, presumably in the form of a "best practices" guideline.

The American Bar Association and the Treasury Department have discussed the possibility of using a "test groups" approach for developing risk-based approach guidance for transactional groups. The test groups may include, at a minimum, the ABA International Law Section and the Real Property, Trust and Estate Law Section. It is also expected that input would be obtained from other transactional ABA sections, such as the Business Law Section, as well as specialty bar associations such as those that responded to the Advance Notice, as well as international bar associations.

It is noted that two bar groups have already provided guidance to their members. The Law Society of England and Wales has already developed a lengthy practice note offering AML guidance of its counsel,[36] and the American College of Trust and Estate Counsel issued its best practices guidance in 2006.[37]

35. A detailed review of the legal organization comments and the approaches is at Shepherd, "The USA Patriot Act: The Complexities of Imposing Anti-Money Laundering Obligations on the Real Estate Industry," 39 REAL PROP. PROB. & TR. J. 403 (2004).

36. The Law Society, Practice Note, http://www.lawsociety.org.uk/productsandservices/practicenotes/aml.page (last visited November 10, 2007)

37. Henry Christensen III, Application to Lawyers of Current Anti-Money Laundering Rules Adopted by the Financial Action Task Force on Money Laundering (FATF) and the United States Government: Recommendations of Good Practices for ACTEC Fellows, 31 AM. COLL. OF TRUST & ESTATE COUNSEL J. 302 (2006), available at http://www.actec.org/resources/publications/notes/PDFNotes/ACTECJournal-Spring2006.pdf.

D. Penalties against Financial Institutions under the Act for Failure to Develop Anti-Money Laundering Programs

2007 Update

Press releases on the FinCEN website[38] indicate that a number of institutions have had major penalties imposed on them for failure to establish or maintain AML programs and other AML violations, including two major institutions in 2007.

Background

As set forth above, the Act imposes strict penalties for the failure of financial institutions to develop anti-money laundering programs. Following the adoption of the Patriot Act and the Executive Order, Bank regulators and prosecutors began to investigate the industry more closely.

Discussion of New Developments

On September 17, 2007, FinCEN and the Comptroller of the Currency announced the assessment of concurrent civil penalties, each in the amount of $10 million, against Union Bank of California, N.A. for violations of the BSA. A single payment of $10 million was made to the Treasury Department. The Bank also consented to a Cease and Desist Order. The enforcement actions were part of a coordinated action with the U.S. Department of Justice, which issued a Deferred Prosecution Agreement and an accompanying $21,600,000 forfeiture. The actions were for failure to maintain an adequate anti-money laundering program that identified and reported indicia of money laundering or other suspicious activity and to timely file suspicious activity reports. The transactions arose out of the Bank's handling of certain Mexican casa de cambio accounts.

On August 6, 2007, actions were taken against two American Express entities. American Express Bank International of Miami, Florida (AEBI) was concurrently assessed $20 million by the Board of Governors of the Federal Reserve System and FinCEN and on the same date, FinCEN fined American Express Travel Related Services Company, Inc., a money services business, $5 million. These orders were part of a coordinated effort with the U.S. Department of Justice, which on the same date announced the execution of a deferred prosecution agreement with AEBI that required it to forfeit $55 million to the United States. After joint application of payments, the total paid by the American Express entities was $65 million. Cease and desist orders were also issued by the Federal Reserve Board. All of these arose out of the failure to establish and maintain adequate AML programs and failure to adequately respond to certain supervisory concerns.

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38. Financial Crimes Enforcement Network, U.S. Department of the Treasury, Press Room/News Releases, http://www.fincen.gov/po_newsreleases.html (last visited November 10, 2007).

Based on the press releases, other financial institutions hit with penalties, starting in 2004, have been:

- Riggs Bank (5/13/04), in the largest civil monetary penalty in the history of the Bank Secrecy Act until that point, in concurrent penalties by FinCEN and the Comptroller of the Currency of $25 million for failure to design and implement an anti-money laundering program tailored to the risks of its business that would have ensured appropriate and timely reporting of suspicious conduct (satisfied by one payment of $25 million to the Department of the Treasury).
- AmSouth Bank of Birmingham, AL (10/12/04) - $10 million jointly by FinCEN and the Federal Reserve Board based on failure to establish adequate AML program and failure to file timely Suspicious Activity Reports (SARs). Concurrent cease and desist orders by the Federal Reserve Board and the Alabama Superintendent of Banks.
- BankAtlantic of Fort Lauderdale, FL (4/26/06) - $10 million each by FinCEN and the Office of Thrift Supervision for failure to implement an adequate AML program that included internal controls and other measures to detect and report money laundering and other suspicious activity (satisfied by one payment o f$10 million to the Department of Justice). Cease and desist order by OTS.
- Liberty Bank of New York (5/19/06) - $600,000 in actions by FinCEN, the FDIC and the New York State Banking Department for violations of federal and state anti-money laundering laws and regulations.
- Beach Bank of Miami, Fl (12/27/06): $800,000 in actions by FinCEN, the FDIC and the Florida Office of Financial Regulation.

E. 2005 Patriot Act Reauthorization

Sixteen of the provisions of the Patriot Act sunsetted in 2005. In the USA Patriot Act Improvement and Reauthorization Act of 2005 (H.R. 3199) (Reauthorization Act), passed on March 2, 2006, fourteen of those sixteen provisions were made permanent, and four year sunset provisions were placed on the other two.[39]

No provisions of the Reauthorization Act directly affected any of the main provisions that are discussed in this article. Sections 115 and 116 place limit on information that can be obtained from financial institutions and provide for judicial review of the letters used by law enforcement to obtain customer information from financial institutions.

39. The full text of the Reauthorization Act can be found at http://www.usdoj.gov/olp/pdf/usa_patriot_improvement_and_reauthorization_act.pdf. A summary analysis (comparing the Act to an earlier Senate version) can be found at http://fpc.state.gov/documents/organization/51133.pdf.

F. Loan Documentation

As with other types of real estate transaction documentation, practitioners should consider the treatment of the Patriot Act, and the Executive Order in documentation of loan transactions.

Categories of Loan Document Provisions

Loan document provisions in connection with the Patriot Act and Executive Order should cover the following four broad categories:[40]

(1) Representations and Warranties from Borrower and Other Transactions Parties;
(2) Covenants;
(3) Reporting Requirements; and
(4) Rights of the Lender.

These are briefly discussed as follows:

(1) Representations and Warranties from Borrower and other Transaction Parties
   (a) Borrower is not on the SDN List of OFAC;[41]
   (b) Borrower is not in violation of anti-money laundering and anti-terrorism financing laws, and entering into the loan transaction will not cause it to be in violation;
   (c) Borrower is not using the loan proceeds for money laundering or other illegal activities;
   (d) If the project is a rental project, Borrower is not leasing the project to persons on the SDN list.
(2) Covenants
   (a) Borrower will comply with all anti-money laundering and antiterrorism financing laws;
   (b) Borrower will comply with further requirements imposed by Lender for its own required compliance and monitoring programs and protocols.
(3) Reporting Requirements
   (a) Borrower agrees to supply periodic reports to show compliance;
   (b) Borrower agrees to recertify the required representations from time to time.
(4) Rights of the Lender
   (a) Lender has the right to disclose to governmental authorities any information obtained by Lender about

40. Acknowledgment is given for the organization of categories (as modified herein) to the American College of Mortgage Attorneys Report of the Patriot Act Subcommittee (April 26, 2006).

41. 31 C.F.R. § 594.202 makes transactions with SDNs null and void. Attorneys may want to consider including in certain transactional opinions assumptions that persons to whom enforceability opinions are being given are not SDNs or blocked persons.

Borrower that is required to be disclosed under applicable laws;

(b) Lender has the right to take various actions in the event of any noncompliance or breach of warranty, including withholding any further advances if the loan is being funded by periodic advances;

(c) If the loan is from an insurance company or other nonbank Lender where the loan proceeds will not go into an account with the bank Lender, Lender requires that all advances will only be made in Borrower's name to an account in a bank formed under the laws of the U.S. (whether federal or state law), or a bank that is not a "foreign shell bank" under the BSA.

Issues and Misperceptions about Loan Documentation Provisions; the Regulators' View

While the distinction should be clear from a reading of this article, one of the misperceptions that exists in the understanding of the Executive Order and the Patriot Act is that they are one and the same. Particular areas of confusion relate to:

(a) the perception that provisions relating to the SDN and blocked persons arise out of the Patriot Act when in fact they arise out of the Executive Order; and

(b) the perception that the provisions are co-extensive in coverage. In fact, the Executive Order extends to "any transaction or dealing by United States persons or within the United States in property or interest in property," all types of transactions – financing, leases, purchase and sales, guaranties, joint venture and partnership transactions, property management, investments, etc. and transactions "with suspected terrorists," or with persons or entities who assist in, sponsor, provide support or services for, are associated with are owned or controlled by or act on behalf of suspected terrorists, whereas the Patriot Act relates to anti-money laundering and reports and records by designated financial institutions. Parties should also not place an unduly high level of comfort on representations and warranties from transaction parties – reliance is only permitted if reasonable, and it is not entirely clear what degree of due diligence permits the reliance to be reasonable. Further, the breach of or reliance on representations and warranties will not insulate an institution from regulatory action.

Conclusion

The provisions of the Bank Secrecy Act, the Patriot Act, the Executive Order and the implementing regulations have, since their enactment, imposed significant obligations on persons affected by them and

significant penalties for non-compliance. Developments have also occurred with respect to international initiatives. Within the past year, extensive interpretation and efforts to impose liability have been added as the measures "mature," with additional developments likely to occur in the near future. It would behoove all those affected to examine their procedures and documents, educate those with responsibilities related to the measures and stay abreast of developments in this area.