Vanderbilt Law Review

Volume 58 | Issue 5 Article 7

10-2005

Leaving No Loopholes for Terrorist Financing: The Implementation of the USA PATRIOT Act in the Real Estate Field

Elizabeth A. Cheney

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I. INTRODUCTION

September 11, 2001 began like any other day but took a drastic turn at 8:45 a.m. Eastern Daylight Time when a plane, hijacked by terrorists, crashed into the northern tower of the World Trade Center, setting it afire.[1] As Americans mourned in silence, a second plane rammed through the southern tower of the World Trade Center at 9:05 a.m. and set it aflame.[2] The horror continued, as a third plane crashed into the Pentagon, a fourth diverted into a field in Pennsylvania, and both towers of the World Trade Center collapsed.[3]

It did not take long for Americans to realize they had been attacked on their own soil by an impervious enemy – terrorists.[4] This kind of attack was unprecedented in U.S. history, and the death toll reached nearly 3,000 within a few hours.[5] President George W. Bush addressed the nation on the night of September 11, stating:

> Terrorist acts can shake the foundations of our biggest buildings, but they cannot touch the foundation of America. These acts shatter steel but they cannot dent the steel of American resolve. . .Today, our nation saw evil, the very worst of human nature, and we responded with the best of America.[6]

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1. CNN.com, September 11: Chronology of Terror, http://archives.cnn.com/2001/US/09/11/chronology.attack/ (last visited Oct. 24, 2005).

2. *Id.*

3. *Id.*

4. *See id.* (noting that the President remarked at 9:30 a.m. on Sept. 11, 2001 that the country had suffered an "apparent terrorist attack").

5. CNN.com, September 11: A Memorial, http://www.cnn.com/SPECIALS/2001/memorial (last visited Oct. 24, 2005).

6. President George W. Bush, Address to the Nation Following Alleged Terrorist Attacks on New York and Washington, D.C. (Sept. 11, 2001), *available at* http://www.pbs.org/newshour/bb/military/terroristattack/bush_speech.html.

Americans quickly determined that not only had terrorists attacked on U.S. soil, but also that terrorists had taken advantage of the U.S. financial system to fund the horrific events of September 11.[7] Government officials suspected that the terrorists laundered money through banks in the United States and abroad, and through other highly valuable assets, including real estate.[8] Consequently, not only did the events of September 11 leave an indelible mark in the hearts and minds of Americans, but these events dramatically changed the country's economy, government, industry, and politics.

One area of the economy remained stable despite the tragic events of September 11: real estate. It remains to be seen, however, whether this sector of the U.S. economy will escape the consequences of the tragedy. On October 26, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act ("Patriot Act") was signed into law.[9] The stated purpose of the law was "to deter and punish terrorist acts in the United States and around the world, to enhance law enforcement investigatory tools, and for other purposes."[10] Towards that end, the Patriot Act enhanced the requirements of the Bank Secrecy Act to eliminate money laundering as Congress determined that money laundering had partially funded the terrorist activities.[11]

Included in the Bank Secrecy Act's definition of financial institutions, adopted by the Patriot Act, were "persons involved in real estate closings and settlements."[12] The Bank Secrecy Act required the creation of a paper trail of important financial records when a transaction involved large amounts of currency to further its goal of "protect[ing] against international terrorism."[13] The Patriot Act expanded these existing reporting requirements and strengthened communication among the reporting entities.[14] The Act also empowered the Treasury Department to determine the extent to which it would regulate certain financial institutions under the

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7. United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001, Pub. L. No. 107-56, § 302, 115 Stat. 272, 296-98 (2001) (codified in scattered sections of the U.S. Code) [hereinafter Patriot Act].

8. *See id.*

9. Alicia L. Rause, *USA PATRIOT Act: Anti-Money Laundering and Terrorist Financing Legislation in the U.S. and Europe Since September 11th*, 11 U. MIAMI INT'L. AND COMP. L. REV. 173, 173 (2003).

10. Patriot Act, *supra* note 7, § 302.

11. Rebecca Gregory, *The Lawyer's Role: Will Uncle Sam Want You in the Fight Against Money Laundering and Terrorism?*, 72 UMKC L. REV. 23, 23-24 (2003).

12. Bank Secrecy Act, 31 U.S.C. § 5312(a)(2)(U) (2000).

13. *Id.* § 5311.

14. NORMAN ABRAMS, ANTI-TERRORISM AND CRIMINAL ENFORCEMENT 9-10 (2003).

Patriot Act. The Department, however, has yet to render a decision regarding the real estate sector.[15]

Implementation of the Patriot Act in the real estate industry, particularly on lawyers in the field, presents a unique question of how to balance the protection of attorney-client communications against the need to reduce terrorist financing activities. Real estate professionals generally support combating money laundering but are hesitant to impose stringent measures on the field because of a variety of concerns.[16] Part II of this Note analyzes the background behind the Patriot Act, other counter-terrorism laws, and money laundering laws. Part III discusses several hurdles in the effort to implement the law and examines different ways the real estate sector can contribute to the war on terror. Part IV proposes a plan to implement the Act in the real estate sector. This proposal would establish a specific list for use in determining who should be primarily responsible for complying with the anti-money laundering procedures of the Patriot Act for each real estate transaction. Designating a person to have primary responsibility will enable the other parties involved in the transaction to rely on the designated party's fulfillment of the duties, thus avoiding conflict and wasted resources.

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15. Gregory, *supra* note 11, at 24.

16. *See, e.g.*, Dechert LLP, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (June 9, 2003), *available at* http://www.fincen.gov/kalogredis.pdf (noting that Dechert LLP supported "FinCEN in its aim of preventing money laundering and the financing of terrorist activities" but expressed "concern about the breadth of the application of the Proposal"); Escrow Institute of California, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 10-11 (June 9, 2003), *available at* http://www.fincen.gov/pothier.pdf (recognizing the Escrow Institute of California's support of the FinCEN's "efforts to strengthen the anti-money laundering system and rules already in effect," but then arguing for the carving out of an exception for residential and smaller commercial real estate transactions); RE/MAX International, Inc., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 1 (May 28, 2003), *available at* http://www.fincen.gov/jesperson.pdf (establishing that RE/MAX supported "the goals and objectives of the Act in its fight to detect and prosecute money laundering activities that finance terrorism and terrorist activities," but supporting an exception for real estate licensees).

II. BACKGROUND: THE DEVELOPMENT OF MONEY LAUNDERING LAWS IN THE UNITED STATES

A. Money Laundering and Terrorist Financing

Though the origin of money laundering is unclear, historians speculate that it has existed for thousands of years.[17] In the United States, money laundering received its name during Prohibition.[18] Restrictions on gambling and drinking "caused a dramatic increase in financial crime" because criminals had to disguise the origins of the large sums of money involved in this illegal activity.[19] The term "money laundering" derives from the practice of using Mafia owned laundromats to hide the large sums of cash received "from extortion, prostitution, gambling and bootleg liquor."[20] Laundromats were ideal because they were cash businesses and criminals were able to merge legitimate and illegitimate funds.[21]

The term "money laundering" was not used in U.S. courts until 1982 in *United States v. $4,255,625.39*.[22] Although money laundering was clearly surfacing as a problem in the United States before that time, the extent of the problem remains unclear.[23] Money laundering rose to prominence in the 1980s and 1990s, in part because of the "unexpected explosion in narcotics trading."[24] Drug trafficking contributed heavily to the money laundering problem, and much of the laundered money was placed "in the U.S. financial system by commingling drug proceeds with funds generated at legitimate businesses, by purchasing real estate and vehicles, and by exploiting

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17. Countermoneylaundering.com, A Brief History of Money Laundering, http://www.countermoneylaundering.com/p08.htm (last visited Oct. 24, 2005).

18. *Id.*

19. *Id.*

20. A Little History about Money Laundering, http://www.unc.edu/courses/pre2000fall/law357c/cyberprojects/spring00/offshore/moneyintro.html (last visited September 7, 2005).

21. *Id.*

22. 551 F. Supp. 314 (S.D. Fla. 1982); *see also* A Little History about Money Laundering, http://www.unc.edu/courses/pre2000fall/law357c/cyherprojects/spring00/offshore/moneyintro.htm l (last visited September 7, 2005).

23. Proximal Consulting, What is Money Laundering? Why is It So Important to Stop It? Some Frequently Asked Questions on the Subject, http://www.proximalconsulting.com/Whatismoneylaundeirng.htm (last visited Oct. 24, 2005) ("In truth nobody knows how much dirty money is being laundered (or attempted to be laundered) on a global basis.").

24. Gary Manger, The Global Response to Money Laundering: How Global Politics Shaped the Response, http://www.aic.gov.au/conferences/2002-ml/part1.html (last visited Oct. 24, 2005).

the gaming industry."[25] Recognizing this problem, the U.S. government criminalized money laundering in 1986 to prevent people from being able "to disguise the true source and nature of their illegally gained wealth."[26]

In 1999, the United Nations assessed the breadth of the international money laundering problem, estimating that "organized criminal syndicates made $1.5 trillion each year."[27] This figure provides a baseline from which to measure the scale of the problem. In reality, this problem is likely much more widespread than reported, as secrecy is the key to its continued success.[28] Some estimate that money laundering is the largest industry on the planet (larger than arms or oil), constituting 3 to 5 percent of the global gross domestic product.[29] In response to this global problem, the United States imposed stricter regulations and joined in international efforts to eliminate the crime throughout the world.[30]

After the events of September 11, the focus of much of the anti-money laundering legislation moved from drug traffickers and other criminals to terrorist financing.[31] According to Interpol,[32] the terrorist "attempts to conceal his activities in preparing his crime to avoid detection; [but] the terrorist's weakest link is the fact that he requires funding. . .the frequency and seriousness of international terrorist acts *are often proportionate* to the financing that terrorists might get."[33] In

25. National Drug Intelligence Center, National Drug Threat Assessment 2003, http://www.usdoj.gov/ndic/pubs3/3300/money.htm (last visited Oct. 24, 2005).

26. *See* A Little History about Money Laundering, http://www.unc.edu/courses/pre2000fall/law357c/cyberprojects/spring00/offshore/moneyintro.html (last visited Oct. 24, 2005) ("Money laundering in the US was not criminalized until the passing of the Money Laundering Control Act of 1986" (citing 18 U.S.C. §§ 1001, 1956, 1957)).

27. Proximal Consulting, What is Money Laundering? Why is It So Important to Stop It? Some Frequently Asked Questions on the Subject, http://www.proximalconsulting.com/Whatismoneylaundeirng.htm (last visited Oct. 24, 2005)

28. *See* Financial Crimes Enforcement Network, About FinCEN/FAQs, http://www.fincen.gov/reg_bsaregulations.html (last visited Oct. 24, 2005) (establishing that money laundering is an enormous problem that extends far beyond drug trafficking).

29. Manger, *supra* note 24.

30. *See* discussion *infra* Part II.B.

31. Manger, *supra* note 24.

32. Interpol is an organization that provides "proactive support for police operations throughout the world" and "whose mission is preventing, detecting and suppressing crime." Interpol, Interpol Vision, Core Functions and Mission, http://www.interpol.int/Public/Icpo/default.asp (last visited Oct. 24, 2005).

33. Interpol, The Financing of Terrorism, http://www.interpol.int/Public/Terrorism/financing.asp (last visited Oct. 24, 2005).

response, governments have begun to combat terrorist financing through heavier regulation in many fields, including real estate.[34]

B. Legislation and History Leading to the Patriot Act

1. The Bank Secrecy Act

Long before September 11, legislators knew that criminals were manipulating the American financial system to integrate illegal money into the marketplace to finance crime and terrorism. Congress initially addressed the issue in 1970 with the Bank Secrecy Act.[35] The Bank Secrecy Act aimed "to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity."[36] The Act proposed to "protect against international terrorism" by mandating the creation of a paper trail of financial records for any transaction involving large amounts of currency.[37] Furthermore, the Act required financial institutions to file Currency Transaction Reports with the Treasury Department for transactions involving more than $10,000 in cash.[38] These reports identify the identity and contact information of the person depositing, withdrawing, or exchanging the cash.

Money laundering was formally established as a crime in 1986 "when Congress enacted 18 U.S.C. §§ 1956-1957, which control[led] domestic and international money laundering as well as undercover sting operations."[39] In 1987, all federally insured depository

34. *See* Gregory, *supra* note 11, at 33 (evidencing that the Gatekeeper Initiative aimed to include lawyers, accountants and other financial intermediaries in the effort to prohibit money laundering and terrorist financing). Although the effort to restrict terrorist financing is associated with anti-money laundering procedures, terrorist financing is somewhat different than traditional money laundering. Countermoneylaundering.com, The Funding of Terrorism, http://www.countermoney laundering.com/p05a.htm (last visited Oct. 24, 2005). Traditional money laundering involves money that is "dirty" when it enters the system; in contrast, terrorist financing usually involves legitimate funds which are intended for illegitimate purposes once in the system. *Id.* Semantically, the two are lumped into one category and will be addressed as such in this Note.

35. Gregory, *supra* note 11, at 27; *see also* Bank Secrecy Act, 31 U.S.C. §§ 5311-5326 (2000) (establishing that the purpose of this subchapter of the Bank Secrecy Act was "to protect against international terrorism").

36. COMPTROLLER OF THE CURRENCY AND ADMINISTRATOR OF NATIONAL BANKS, BANK SECRECY ACT/ANTI-MONEY LAUNDERING: COMPTROLLER'S HANDBOOK 1 (2000), *available at* http://www.occ.treas.gov/handbook/bsa.pdf.

37. 31 U.S.C. § 5311 (2000).

38. *Id.* § 5313(a); 31 C.F.R. § 103.22 (2002).

39. Gregory, *supra* note 11, at 27.

institutions and credit unions were required to establish anti-money laundering policies.[40] These policies include using due diligence to detect money laundering, educating employees in regard to money laundering, and performing internal audits to ensure the policies were being successfully implemented.[41]

To evade this reporting system, criminals began structuring deals that enabled them to deposit money in amounts smaller than $10,000. To combat this problem, Congress amended the Bank Secrecy Act to require Suspicious Activity Reporting,[42] which requires financial institutions to report any transaction that might involve a possible violation of law or regulation.[43] This amendment provided law enforcement officers with more information than they would have received in a simple report of all transactions over $10,000.[44]

2. Financial Crimes Enforcement Network

In 1990, the Department of Treasury created the Financial Crimes Enforcement Network ("FinCEN") "to provide an analytical intelligence network focused on financial crimes."[45] The FinCEN maintained a database of all Currency Transaction Reports and Suspicious Activity Reports (SARs) and made them available to law enforcement officials at all levels.[46] Currently, the FinCEN also enforces relevant sections of the Patriot Act on financial institutions to encourage communication between law enforcement officers and financial institutions.[47]

3. Financial Action Task Force

As laws began to more effectively eliminate money laundering, criminals adapted their procedures to avoid detection. Money launderers tried to avoid the strengthened reporting system in the

40. 31 U.S.C. § 5313 (2000); 67 Fed. Reg. 21,110-11 (Apr. 29, 2002).

41. 31 U.S.C. § 5318(h)(1)(A)-(D) (2000).

42. Gregory, *supra* note 11, at 27-28 n.35 (citing U.S. DEP'T OF JUSTICE OFFICE OF LEGAL EDUCATION, MONEY LAUNDERING AND TERRORIST FINANCING USABOOK ONLINE 116 (2002) ("Congress enacted 31 U.S.C. § 5324 to curtail drug dealers from laundering profits through structured schemes intended to avoid the reporting requirements.")).

43. 31 U.S.C. § 5318(g) (2000).

44. Gregory, *supra* note 11, at 28. Note that reporting deposits of more than $10,000 is still required.

45. *Id.*

46. *Id.*

47. Anti-Money Laundering Program Requirements for "Persons Involved in Real Estate Closings and Settlements," 68 Fed. Reg. 17,569 (April 10, 2003) (to be codified at 31 C.F.R. pt. 103) [hereinafter Requirements for Persons Involved in Real Estate Closings and Settlements].

United States by sending money to foreign shell corporations or banks in countries with lax reporting requirements.[48]

At the 1989 G-7 Summit meeting, the global community responded to what was becoming an international money laundering problem by establishing the Financial Action Task Force on Money Laundering ("FATF").[49] This task force assembled legal, financial, and law enforcement experts from across the world to develop and promote policies to combat money laundering and terrorist financing.[50] FATF designed the Forty Recommendations, which summarized the money laundering countermeasures to be adopted by countries across the globe. The Recommendations emphasized the importance of establishing procedures for customer identification, record keeping, and auditing of compliance with the standards.[51] Many countries subsequently implemented the Recommendations within their borders.[52]

As criminals began to once again exploit loopholes in these procedures, a G-8 Conference on Combating Transnational Organized Crime convened in 1999 to discuss expanding international efforts beyond solely regulating financial institutions.[53] This initiative originated from findings in a 1998 United Nations report which concluded: "money launderers frequently use lawyers and accountants to help them hide funds."[54] The next step, which evolved into the Gatekeeper Initiative, sought uniformity in regulating professionals—particularly attorneys, accountants, and other financial intermediaries.[55] The Gatekeeper Initiative "call[ed] on countries to

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48. Gregory, *supra* note 11, at 29-30.

49. *Id.* at 31; *see also* Financial Action Task Force, More About the FATF and Its Work, http://www1.oecd.org/fatf/AboutFATF_en.htm (last visited Oct. 24, 2005) (recognizing that "in response to mounting concern over money laundering, the Financial Action Task Force on Money Laundering was established by the G-7 Summit that was held in Paris in 1989"); COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 1 (2002), *available at* http://www.fincen.gov/krauland.pdf (describing the FATF as "an inter-governmental body established by the G-7 Summit that was held in Paris in 1989 for the purpose of developing and promoting policies, both at national and international levels, to combat money laundering").

50. Financial Action Task Force, More About the FATF and Its Work, http://www1.oecd.org/fatf/AboutFATF_en.htm (last visited Oct. 24, 2005).

51. Gregory, *supra* note 11, at 32.

52. *Id.* at 31-32.

53. *Id.* at 33.

54. *Id.*; *see* FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, REVIEW OF THE FATF FORTY RECOMMENDATIONS CONSULTATION PAPER 97-98 (2002), *available at* http://www1.oecd.org/fatf/pdf/Review40_en.pdf (summarizing how lawyers have been frequently linked to money laundering schemes).

55. Gregory, *supra* note 11, at 33; *see also* COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE

consider enlisting these professionals as 'gatekeepers' to the domestic and international financial and business markets to prevent money laundering and terrorist financing by, among other things, adopting certain recommendations promulgated by the FATF."[56]

Lawyers were targeted by the Gatekeeper Initiative because the task force recognized an increasingly sophisticated approach by money launderers as more countries responded to the problem.[57] The task force determined that terrorists were frequently using lawyers to facilitate money laundering transactions and that this activity could be detected and deterred by imposing reporting requirements on lawyers.[58]

Some member countries, including New Zealand, the United Kingdom, and Switzerland, implemented the Recommendations not only for financial institutions, but also for these front-line professionals to strengthen their anti-money laundering efforts.[59] The United States, however, has been hesitant to implement the Gatekeeper Initiative because "the role of lawyers as independent professionals and their ethical obligations to serve the interests of their clients objectively run counter to the gatekeeper notion that lawyers essentially act as government agents."[60] American lawyers are concerned that complying with the Gatekeeper Initiative "would have the unintended effect of impairing client compliance with law, and could potentially undermine the fundamental principles underlying the legal system in the United States."[61]

In response to the events of September 11, the task force held a special meeting to develop a plan to combat terrorist financing.[62]

CONSULTATION 1 (2002), *available at* http://www.fincen.gov/krauland.pdf (explaining that the Gatekeeper Initiative evolved as one of the FATF's anti-money laundering initiatives and "is directed at certain professionals, including lawyers, accountants and auditors, who are involved in assisting clients with domestic and international financial transactions and business dealings").

56. COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 1 (2002), *available at* http://www.fincen.gov/krauland.pdf.

57. *Id.* at 5.

58. *Id.*

59. *Id.* at 26; Gregory, *supra* note 11, at 33; FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, REVIEW OF THE FATF FORTY RECOMMENDATIONS CONSULTATION PAPER 97-98 (2002), *available at* http://www1.oecd.org/fatf/pdf/Review40_en.pdf.

60. Kevin L. Shepherd, *USA PATRIOT Act and the Gatekeeper Initiative: Surprising Implications for Transactional Lawyers*, A.B.A. PROB. & PROP., Sept.-Oct. 2002, at 30.

61. COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 4 (2002), *available at* http://www.fincen.gov/krauland.pdf.

62. Financial Action Task Force, More About the FATF and Its Work, http://www1.oecd.org/fatf/AboutFATF_en.htm (last visited Oct. 24, 2005).

FATF issued Eight Special Recommendations in an effort to "deny access for terrorists and their supporters to the international financial system."[63] These special recommendations included criminalizing terrorist financing, freezing and confiscating terrorists' assets, reporting suspicious transactions related to terrorism, promoting international cooperation, and reviewing regulations of non-profit organizations.[64]

4. Terrorist Financing Executive Order

On September 24, 2001, prior to passing the Patriot Act, President George W. Bush issued the Terrorist Financing Executive Order ("Executive Order") to "starve terrorists of funding, turn them against each other, rout them out of their safe hiding places, and bring them to justice."[65] The order, later codified in the Patriot Act, expanded the Department of Treasury's power, increased the government's ability to block U.S. assets being used for terrorism, and prohibited foreign banks from entering the U.S. market unless they agreed to freeze assets of terrorists abroad.[66]

The Executive Order established a Specially Designated Nationals and Blocked Entities list of alleged terrorists and terrorist organizations operating in the United States and across the world.[67] According to the Executive Order, the Secretaries of State and Treasury could add names to this list of individuals or groups that posed a threat of committing acts of terrorism.[68] Names were only added to the list after a thorough process that included: a criminal investigation, review by the Department of Justice, an opportunity for administrative appeal for any person or organization that felt it had been wrongly placed on the list, and the opportunity to appeal the administrative decision to a Federal Court.[69] The United States does

63. *Id.*

64. Financial Action Task Force, Special Recommendations on Terrorist Financing, http://www1.oecd.org/fatf/SRecsTF_en.htm (last visited Oct. 24, 2005).

65. Press Release, Office of the Press Secretary, Fact Sheet on Terrorist Financing Executive Order (Sept. 24, 2001), *available at* http://www.whitehouse.gov/news/releases/2001/09/print/20010924-2.html.

66. Rause, *supra* note 9, at 180-81.

67. *Id.* at 181.

68. Morrison & Foerster, LLP, The Legal Response to the September 11 Attacks: The USA PATRIOT Act, the Executive Order on Prohibited Dealings with Terrorists, and the EU Directive on Money Laundering, http://www.mofo.com/news/updates/files/update600.html (last visited Oct. 24, 2005).

69. Press Release, United States Mission to the United Nations, Transcript of Press Roundtable Concerning Executive Order 13224 Blocking Terrorist Property (Feb. 11, 2002), *available at* http://www.un.int/usa/02_016.htm.

not produce this list on its own; countries across the globe contribute names and use the list to protect their own economies.[70]

5. European Union Money Laundering Directive 2001/97/EC

In response to the events of September 11, the European Union amended its own money laundering directive to cover non-financial activities and professions.[71] The Revised Directive extended requirements "regarding client identification, record keeping and reporting of suspicious transactions to external accountants and auditors, real estate agents, notaries, lawyers, dealers in high-value goods, . . . auctioneers and casinos."[72] The previous directive had focused on the laundering of drug proceeds; but the amendments expanded the directive's reach to cover "all serious crimes."[73] The Revised Directive made significant advances in fighting terrorist financing but still has not closed the loophole for money obtained through "humanitarian" efforts.[74]

C. The USA PATRIOT Act and Real Estate

The passage of the Patriot Act continued the trend of enacting anti-terrorism legislation in response to a specific terrorist event or series of events.[75] The Patriot Act passed within six weeks of the September 11 attacks, an unusually quick turnaround for such a long and complex law.[76] Few committee hearings were held to discuss the bill and "no official conference met to reconcile the differences between

70. Rause, *supra* note 9, at 181-83.

71. *Id.* at 183.

72. Morrison & Foerster, LLP, The Legal Response to the September 11 Attacks: The USA PATRIOT Act, the Executive Order on Prohibited Dealings with Terrorists, and the EU Directive on Money Laundering, http://www.mofo.com/news/updates/files/update600.html (last visited Oct. 24, 2005).

73. *Id.* (recognizing that "the Revised Directive amends Directive 91/308/EEC to broaden the definition of money laundering and extends its provisions to certain non-financial activities and professions").

74. *See* Rause, *supra* note 9, at 184-85 (explaining that terrorists have used charities to raise money for humanitarian causes and have also diverted some of the money to finance terrorist acts). "The USA PATRIOT Act closes this loophole with respect to money laundering because its 'provisions apply to all terrorist assets, including legally obtained funds, if intended for use in planning, committing or concealing a terrorist act.' However all countries do not have this standard yet." *See id.* (citing Elise Bean, *Summary of Key Anti-Money Laundering Provisions in Anti-terrorism Bill H.R. 3162/P.L. 107-56*, MONEY LAUNDERING ALERT, Nov. 2002, at 89-90)).

75. ABRAMS, *supra* note 14, at 10.

76. *Id.* In the wake of September 11, however, the country was determined to take significant steps toward eliminating the threat of terrorism in the United States, so the bill passed with little discussion or controversy. *Id.*

the House and Senate bills."[77] Instead, a group of administrative officials met to discuss the differences in the bills and to settle on the final version, which was over 300 pages long.[78]

The Patriot Act did not add extensive substance to the existing anti-terrorism crimes. Rather, it strengthened law enforcement tools that could be used to attack terrorist groups and activities, expanded anti-money laundering provisions, and added provisions specifically related to the events of September 11.[79] The anti-money laundering provisions were particularly expansive because Congress had reason to believe that "money laundering, and the defects in financial transparency on which money launderers rely, [were] critical to the financing of global terrorism and the provision of funds for terrorist attacks."[80]

To launder money, criminals usually organize large sums of money into smaller sums of money to disguise the magnitude of their transactions.[81] To avoid detection, they deposit these smaller amounts into banks or use the money to purchase other instruments—including money orders, real estate, and other investments—and therefore move the illegally obtained money further from its origin.[82] Eventually, the money re-enters the economic system as legitimate funds.[83]

Real estate could be vulnerable to money laundering at all stages of the process, including in "placement," "layering," and "integration."[84] The "placement" stage is the initial stage where illegally obtained funds are introduced to the financial system. In the real estate field, cash down payments for the purchase of real estate are an example of placements.[85] The "layering" stage is when the funds are distanced from their source through varying financial transactions. Examples of layering include buying, selling, or exchanging multiple pieces of real estate to frustrate tracing the illicit funds.[86] Finally, the "integration" stage occurs when the illegal funds are legitimated. An example of layering is 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

77. *Id.*

78. *Id.*

79. *Id.* at 10-11.

80. Patriot Act, *supra* note 7, § 302.

81. Gregory, *supra* note 11, at 26.

82. *Id.*

83. *Id.*

84. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569.

85. *Id.* at 17,570.

86. *Id.*

check that the money launderer then has the ability to represent as the proceeds of a legitimate business transaction."[87]

Congress recognized that money laundering was financing acts of terrorism and enacted the Patriot Act to strengthen "the ability of the government, along with our partners in the financial sector, to identify dollars flowing through our financial system in support of nefarious acts, and to prevent new dollars from entering the system."[88] The creation of new lines of communication between financial institutions and the government through the Patriot Act has enabled the United States to identify at least 361 individuals and organizations as terrorists or terrorist supporters and to "freeze and seize approximately $200 million in terrorist-related assets."[89]

Pursuant to the Patriot Act, financial institutions are required to establish anti-money laundering programs, including: "the development of internal policies, procedures and controls; the designation of a compliance officer; an ongoing employee training program; and an independent audit function to test programs."[90] The Secretary of the Treasury was given the authority to impose these requirements upon different financial institutions while considering "the extent to which the requirements imposed under this section are commensurate with the size, location, and activities of the financial institutions to which such regulations apply."[91] Financial institutions were originally defined in the Bank Secrecy Act and amended by the Patriot Act to include "persons involved in real estate closings and settlements," along with twenty-six other financial actors.[92]

The Secretary of the Treasury delegated the authority to implement the Bank Secrecy Act, and subsequently Section 352 of the Patriot Act which applies to real estate, to the Director of the FinCEN.[93] However, on April 29, 2002, and again on November 6, 2002, the FinCEN temporarily exempted certain financial institutions, including those involved with real estate closings and settlements, from establishing anti-money laundering programs.[94] These institutions were originally exempted to allow time to investigate "the affected industries and to consider the extent to which anti-money

87. *Id.*

88. John W. Snow, *Blood Money*, WALL ST. J., Apr. 23, 2004, at A14.

89. *Id.*

90. Patriot Act, *supra* note 7, §§ 352(a)(1)(A)-(D).

91. *Id.* § 352(c).

92. 31 U.S.C. § 5312(a)(2)(U) (2000).

93. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569.

94. *Id.*

laundering program requirements should be applied to them."[95] The exemption of the real estate sector was reconsidered in June of 2003 when the FinCEN issued the Advance Notice of Proposed Rulemaking ("ANPRM").[96]

III. ANALYSIS: THE PROBLEMS AND OPPORTUNITIES ASSOCIATED WITH IMPLEMENTING THE PATRIOT ACT IN THE REAL ESTATE FIELD

A. Section 352 of the Patriot Act and the Advanced Notice of Proposed Rulemaking

While those involved in real estate closings and settlements were exempted from establishing the minimum anti-money laundering programs to comply with Section 352 of the Patriot Act,[97] other financial institutions, including depository institutions, broker dealers, mutual funds and others, immediately implemented anti-money laundering programs in an attempt to meet the requirements of the Patriot Act.[98] Most of the financial institutions implemented programs that contained:

> customer identification procedures, customer due diligence procedures, suspicious activity reporting procedures and large currency transaction reporting procedures. The customer identification and customer due diligence procedures are typically risk-hased in nature, meaning the higher the risk-profile of the bank customer or the transaction itself, the more due diligence that must be performed on that customer.[99]

Implementing similar anti-money laundering programs in the real estate sector, however, presented new problems because so many people are involved in real estate transactions. Furthermore, because attorneys are frequently involved in these transactions, concerns arose about interfering with the attorney-client privilege.[100] To answer

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95. *Id.*

96. *Id.*

97. *Id.*

98. Real Property, Probate & Trust Law Section of the Florida Bar, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as applied to Real Estate (June 9, 2003), *available at* http://www.fincen.gov/guttmann.pdf.

99. *Id.*

100. *See* A.B.A. Section of Real Property, Probate and Trust Law, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as applied to Real Estate (June 9,

some of the questions surrounding the uncertainty in implementation of anti-money laundering procedures in real estate, the FinCEN issued an ANPRM.[101]

After issuing an ANPRM for the regulation of "persons involved in real estate closings and settlements," the FinCEN accepted comments for two months.[102] The ANPRM defined a real estate closing or settlement as "the process in which the purchase price is paid to the seller and title is transferred to the buyer" and recognized that the process may be carried out in different ways, such as the parties meeting face to face to conduct the closing or an escrow agent handling the documents without the parties physically meeting.[103] The primary questions asked by the FinCEN included:

> (1) what are the money laundering risks in real estate closings and settlements...(2) how should persons involved in real estate closings and settlements he defined...(3) should any persons involved in real estate closings or settlements he exempted from coverage under section 352 [and]...(4) how should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?[104]

The agency received over fifty comments from individuals and large organizations, including the American Bar Association ("ABA"), American Land Title Association, RE/MAX International, Inc., Mortgage Bankers Association, and the National Association of Realtors.[105] Many who submitted comments supported the Patriot Act and the FinCEN's effort to implement the Act on financial institutions. However, most were hesitant to impose the anti-money laundering provisions on those involved in the real estate field in the same way as the provisions had been applied to other financial institutions.[106] Since the close of the comment period, the agency has remained silent as it continues to analyze the problems related to implementing an anti-money laundering program in the real estate industry.[107]

2003), *available at* http://www.fincen.gov/belcher.pdf ("imposing the Section 352 AML program requirements on lawyers would adversely affect the attorney-client privilege and would detract from the role that lawyers play in assisting members of society to understand and comply with the rule of law.").

101. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569-71.

102. *Id.*

103. *Id.* at 17,569.

104. *Id.*

105. Financial Crimes Enforcement Network, Comments on FinCEN Regulations, http://www.fincen.gov/reg_352comments.html (last visited Oct. 24, 2005).

106. *See* sources cited *supra* note 16.

107. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569; *see also* Patriot Act, *supra* note 7, § 352(a)(1)(C).

B. Money Laundering Risks in Real Estate Closings and Settlements

According to the ANPRM, the real estate industry was vulnerable to money laundering at all stages—including placement, layering, and integration—because the industry dealt in high value assets.[108] For example, a person could buy real estate with a large cash down payment in order to introduce laundered money into the financial system at the placement stage.[109] Then, real estate could be vulnerable at the layering stage when, for example, the laundered money was used to purchase a piece of property that was then resold or swapped a few times to make it more difficult to determine the true source of the funds.[110] Finally, the real estate industry could be vulnerable at the integration phase "when real estate [wa]s sold by a money launderer to a bona fide purchaser and the purchaser, or his or her financial institution, provide[d] the money launderer with a check that the money launderer then has the ability to represent as the proceeds of a legitimate business transaction."[111]

Many of those commenting on the FinCEN's arguments regarding the vulnerability of the real estate industry recognized the risk of money laundering but perceived this risk to be quite low.[112] First, they argued that real estate is a rather illiquid investment making it a less effective way to launder money than investing in stock or depositing the money in a bank account.[113] Second, money launderers usually want to retrieve their money quickly from the legitimate source, but retrieving money from a real estate sale would be a relatively slow process with extensive paperwork.[114] Some of the

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108. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569.

109. *Id.*

110. *Id.* at 17,569 n.6.

111. *Id.* at 17,569 n.7.

112. American Land Title Association, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 4-8 (June 5, 2003), *available at* http://www.fincen.gov/vomeigen.pdf; America's Community Bankers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3 (June 10, 2003), *available at* http://www.fincen.gov/bahin.pdf; Premier Title Company, Ltd., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as applied to Real Estate, at 1-2 (May 23, 2003), *available at* http://www.fincen.gov/baker.pdf.

113. American Land Title Association, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as applied to Real Estate, at 6-8 (June 5, 2003), *available at* http://www.fincen.gov/vomeigen.pdf; Dechert LLP, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as applied to Real Estate, at 3-4 (June 9, 2003), *available at* http://www.fincen.gov/kalogredis.pdf.

114. *See* sources cited *supra* note 113.

paperwork would require client identification and the performance of due diligence measures when financial institutions were partially financing the sale.[115] Further, the transaction would be reflected in the public records.[116] Therefore, little opportunity would exist for the buyer or seller to remain anonymous.[117] Finally, current safeguards require substantial investigation of "the buyer's authority and ability to perform the transaction, as well as the investigation of the condition and performance of the real estate."[118] These safeguards already provide significant protection from money laundering in the real estate field.

In the face of widespread industry skepticism, the ANPRM offered examples of each stage of money laundering in the context of real estate transactions.[119] In the first example, detailed in *United States v. High*,[120] the defendants owned and operated a real estate business that they used to enable drug dealers to convert their illicit proceeds into real estate assets by structuring the transactions to stay below the reporting requirement of $10,000 in cash. The FinCEN also cited *United States v. Leslie*,[121] in which a defendant used his own real estate company to exchange drug funds in cash for checks from the real estate business that were supposed to be used to buy real estate. No real estate was actually purchased or sold, however, so the money laundering occurred through the issuance of the check from the business account.[122] The final example was *United States v. Nattier*,[123] in which the defendants managed a real estate investment firm and

115. *Id.*

116. *Id.*

117. *Id.*

118. Mortgage Bankers Association of America, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 4 (June 6, 2003), *available at* http://www.fincen.gov/kempner.pdf; *see also* Dechert LLP, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3-4 (June 9, 2003), *available at* http://www.fincen.gov/kalogredis.pdf (mentioning the current existence of "multiple avenues of due diligence scrutiny performed by diverse parties" in commercial real estate transactions that render them "an improbable vehicle for money laundering").

119. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569-70

120. 117 F.3d 464 (11th Cir. 1997).

121. 103 F.3d 1093 (2d Cir. 1997).

122. *Id.* at 1096-97; *see also* National Association of Realtors, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (November 6, 2003), *available at* http://www.fincen.gov/whatley.pdf (noting that in *United States v. Leslie*, "the defendant claimed that he intended to purchase property with the illegal funds, but he was convicted for exchanging ill-gotten cash for checks. Any company with a checking account is subject to abuse in the same manner").

123. 127 F.3d 655 (8th Cir. 1997).

one of the defendants embezzled funds from a bank where he worked and deposited the money into his co-defendants' business account. Using the embezzled money, the defendants then purchased property in order to disguise the embezzled funds.[124]

Although each of these cases involved real estate and money laundering in some manner, none demonstrated situations in which money laundering would have been prevented had the proposed anti-money laundering regulations been in place.[125] In all of these cases, the defendants, usually real estate business owners, knowingly participated in money laundering schemes and purposely structured the transactions to avoid appearing suspicious, while disguising the laundered funds as legitimate through real estate or a check from the real estate business. Because of their employment with real estate companies, these defendants would probably have been at least partially responsible for carrying out the requirements of the anti-money laundering program. This would have included the utilization of customer due diligence and investigation of the legitimacy of the funds. In all likelihood, the defendants in these cases would not have turned themselves in to the authorities.

Though the cases mentioned in the AMPRM fail to demonstrate a likely risk for real estate transactions to be utilized for money laundering, more recent cases do demonstrate this risk. For example, in *United States v. Messino*,[126] the defendant laundered money at the placement stage by purchasing real estate from a seller in installment payments with drug proceeds over twelve to fifteen months.[127] In this case, the defendant bought a piece of land through

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124. *Id.* at 658-59; *see also* National Association of Realtors, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (November 6, 2003), *available at* http://www.fincen.gov/whatley.pdf (establishing that "using the embezzled funds, defendants purchased property through the account of the investment firm in an attempt to launder the funds.").

125. *See* Countrywide Home Loans, Inc., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2-3, *available at* http://www.fincen.gov/mills.pdf (recognizing that in these cases the defendants were directly involved in the criminal scheme and noting that the Treasury needed to take a closer look at the true risk of traditional real estate transactions being used for money laundering); National Association of Realtors, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (November 6, 2003), *available at* http://www.fincen.gov/whatley.pdf (mentioning that in each of these cases "the principals of real estate companies willingly participated in the criminal enterprise and were convicted as criminals"). *Cf.* American Land Title Association, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 5-6 (June 5, 2003), *available at* http://www.fincen.gov/vomeigen.pdf (asserting that no real estate closers were actually involved in these money laundering transactions).

126. 382 F.3d 704, 711-12 (7th Cir. 2004).

127. *Id.*

an oral sale and organized the sale so that his name was not attached to the real estate transaction. He then manipulated an attorney into drawing up the closing documents without his name included on them.[128] The defendant paid $40,000 for the property over a few months in $7,000 installments, avoiding the IRS reporting requirements that would attach upon receipt of a $10,000 cash payment.[129] The Seventh Circuit Court of Appeals, affirming the district court's decision, decided that this transaction looked suspicious because it was marked by "unusual secrecy surrounding transactions, careful structuring of transactions to avoid attention, folding or otherwise depositing illegal profits into the bank account or receipts of legitimate business, use of third parties to conceal the real owner, or engaging in unusual financial moves culminating in a transaction."[130]

Similarly, in *United States v. Bivins*,[131] the defendants utilized traditional real estate transactions to place drug money in the legitimate financial arena by purchasing property. The appellate court upheld the defendants' conviction for money laundering conspiracy because they used drug proceeds to buy real estate in order to conceal the illegitimacy of their funds.[132] In both examples of money laundering at the placement stage, anti-money laundering procedures probably would have caused the defendants' actions to be reported since further investigation might have aroused suspicion.

Real estate transactions have also been used to hide illegally obtained money at the layering stage. For example, in 2002, in *United States. v. Gricco*, a defendant's conviction for money laundering was upheld by the Third Circuit which found that the defendant deposited $169,000 over three years into bank accounts and disguised the laundered money through real estate purchases.[133] The court determined that the defendant "structured his currency transactions, laundered money through real estate purchases, and hid assets under family members' names."[134] These crimes could possibly have been avoided through further investigation and anti-money laundering procedure of the real estate process.

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128. *Id.*

129. *Id.* at 711.

130. *Id.* at 712 (citing United States v. Esterman, 324 F.3d 565, 573 (7th Cir. 2003) for the *Esterman* standard of intention to conceal).

131. 104 Fed. Appx. 892 (4th Cir. 2004).

132. *Id.* at 896-97.

133. United States. v. Gricco, 277 F.3d 339 (3d Cir. 2002).

134. *Id.* at 361.

Similarly, in *United States v. 1948 South Martin Luther King Drive*, the defendant utilized complex real estate transactions in the layering stage to aid in money laundering.[135] The defendant admitted to using drug proceeds to purchase numerous properties in family members' names to disguise the true nature of the funding.[136] Deeper investigation of the finances used to purchase the real estate could possibly have prevented the crime.

Though some cases indicate that anti-money laundering programs would not have prevented the crimes, other cases demonstrate that real estate remains at least somewhat vulnerable to money launderers because the transactions involve highly valued assets.[137] Though real estate is less liquid than other assets, and transactions are more difficult to keep anonymous,[138] heavy regulation of other assets makes it more likely that criminals will utilize real estate transactions to legitimize their funds.[139] If history is a guide, as soon as safeguards are implemented to protect certain financial avenues from money laundering, criminals will seek other openings to place, layer, and integrate their laundered funds.[140]

C. Defining "Persons Involved in Real Estate Closings and Settlements"

Many people are involved in real estate closings and settlements, including real estate brokers, attorneys, banks, mortgage brokers or other financing entities, title insurance companies, escrow agents, and appraisers. [141] Yet, neither the Patriot Act nor its legislative history defines the phrase "persons involved in real estate

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135. 270 F.3d 1102 (7th Cir. 2001).

136. *Id.* at 1112-13.

137. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,569; *see also* American Land Title Association, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate at 7 (June 5, 2003), *available at* http://www.fincen.gov/vomeigen.pdf (stating that "it is undeniable that real estate can be used for integration, as can any other traditional asset.").

138. Dechert LLP, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3 (June 9, 2003), *available at* http://www.fincen.gov/kalogredis.pdf.

139. America's Community Bankers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 1-2 (June 10, 2003), *available at* http://www.fincen.gov/bahin.pdf.

140. For instance, money launderers routinely deposited cash in amounts less than $10,000 to avoid the reporting requirements and then transferred the resulting laundered funds into international bank accounts. Gregory, *supra* note 11, at 27, 33.

141. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,570.

closings and settlements."[142] The FinCEN offered as a "guiding principle in defining the phrase" that its definition should "include those persons whose services rendered or products offered in connection with a real estate closing or settlement. . .can be abused by money launderers."[143] Many comment letters supported a specific and narrow definition of the phrase to ensure effective enforcement of the provision.[144]

The FinCEN has not yet defined the phrase but has indicated that it will do so in the near future.[145] The FinCEN must balance many factors in determining whom to incorporate under the definition, including ability to identify the purpose and nature of the transaction, importance to successful completion of the transaction, roles in the money laundering transaction, and finally, "involvement with the actual flow of funds used to purchase the property."[146] Deciding whom to include in the definition will be key in establishing this procedure in the real estate sector because the breadth of the definition will determine how many people the Act affects.

D. *Exempting from Coverage Those who are Involved in Real Estate Closings and Settlements*

1. General Exemptions for Those Involved in Real Estate Closings and Settlements

The FinCEN also solicited comments regarding which entities should be exempt from the law in the real estate sector. The FinCen hypothesized that financial institutions, which were already subject to anti-money laundering programs in other areas, as well as those

142. *Id.*

143. *Id.*

144. A.B.A. Section of Real Property, Probate and Trust Law, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 5-6 (June 9, 2003), *available at* http://www.fincen.gov/belcher.pdf; Mortgage Bankers Association of America, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (June 6, 2003), *available at* http://www.fincen.gov/kempner.pdf; The Real Estate Roundtable, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 4-5 (June 6, 2003) *available at* http://www.fincen.gov/deboer.pdf.

145. *See* Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,571 (attempting to establish "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").

146. *Id.* at 17,570.

parties who purchase and sell their own real estate, should be exempt.[147] The agency sought comments on this subject specifically from "real estate professionals and those who trade[d] in real estate on a commercial basis."[148] Mortgage companies, small proprietors and sole practitioners, settlement agents, small banks, qualified intermediaries, real estate licensees, real estate brokers, title abstractors, inspectors, surveyors, appreciators, attorneys, purchasers, and sellers were all mentioned as possible exemptions in the comment letters.

While the Mortgage Bankers Association of America ("MBA") claimed to support the FinCEN's goal of eliminating terrorist financing through the Patriot Act, it expressed concern regarding the implementation of the requirements of the Act on the real estate sector.[149] It hypothesized that this would result in higher costs for training, implementation, and auditing, which could lead to confusion and less effective implementation.[150] Since banks, savings associations, mortgage companies, and mortgage brokers were "already covered or will be covered by a separate rule," MBA argued that all of these entities should be exempted from coverage in the real estate sector.[151] MBA agreed with the FinCEN's suggestion in the ANPRM to exempt those already required to implement anti-money laundering programs in other areas.[152]

Many arguing for exemptions were concerned that the increased costs associated with the implementation of anti-money laundering programs would outweigh the minimal benefits realized. They worried that the costs of this increased regulation would ultimately be passed on to consumers and negatively impact real estate development.[153] For example, the American Land Title Association recommended an exemption for small proprietorships and sole practitioners, including title insurance agents and abstractors, who served as real estate closers because these businesses would be

147. *Id.* at 17,571.

148. *Id.*

149. Mortgage Bankers Association of America, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 6-7 (June 6, 2003), *available at* http://www.fincen.gov/kempner.pdf.

150. *Id.*

151. *Id.* at 6.

152. *Id.* at 7.

153. Escrow Institute of California, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 9 (June 9, 2003), *available at* http://www.fincen.gov/pothier.pdf.

too small to shoulder the increased costs.[154] The Escrow Institute of California also advocated exempting settlement agents because they were already subject to reporting requirements for certain cash transactions.[155]

Others recommended exemptions for certain individuals who operated on the periphery of transactions and did not possess enough information about the financial transaction to serve as legitimate safeguards to prevent money laundering. Attorneys' Title Guaranty Fund, Inc. encouraged exemption for title insurance companies because they were "typically limited to providing information about matters appearing in the public record" and therefore usually had "little or no information about the structure of the transaction."[156] Because title insurance companies supposedly did not have most of the vital information for detecting money laundering, the Attorneys' Title Guaranty Fund argued that the costs of including title insurance companies in "persons involved in real estate closings and settlements" outweighed the benefits.[157] Further, since title abstractors, inspectors, and surveyors were not typically involved in handling the funds of a real estate transaction, Premier Title Company, Ltd., argued those groups should be exempted from the anti-money laundering regulation.[158] Similarly, since appraisers were "not in the position to assist in the conversion of illegal money to a tangible asset," the Appraisal Institute argued these individuals should also be exempted from coverage.[159] Likewise, real estate licensees were rarely involved with the flow and distribution of funds in a real estate transaction, according to RE/MAX International, Inc.,

154. American Land Title Association, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 9-10 (June 5, 2003), *available at* http://www.fincen.gov/vomeigen.pdf.

155. Escrow Institute of California, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 8-9 (June 9, 2003), *available at* http://www.fincen.gov/pothier.pdf.

156. Attorneys' Title Guaranty Fund, Inc., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (June 9, 2003), *available at* http://www.fincen.gov/birnbaum.pdf.

157. *Id.* at 3.

158. Premier Title Company, Ltd., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (May 23, 2003), *available at* http://www.fincen.gov/baker.pdf.

159. Appraisal Institute/American Society of Appraisers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2-3 (Nov. 6, 2003), *available at* http://www.fincen.gov/hummel.pdf.

and were therefore in an inferior position to identify potential sources of money laundering.[160]

The FinCEN suggested that purchasers and sellers of their own real estate should be exempted from coverage,[161] but that idea received mixed reactions. The American Bar Association ("ABA") agreed that some buyers and sellers should be exempted but disagreed with the broad exemption set forth by the FinCEN.[162] The ABA expressed concerns that people with less knowledge of financing transactions may be responsible for shouldering the burden of compliance, while the buyer or seller would be in a better position to fulfill these requirements.[163] Yet, the ABA suggested that an exemption should "apply to purchasers and sellers of their own personal residences and to other real estate professionals involved in a commercial real estate transaction who have only a tangential relationship with the closing or settlement process."[164] Conversely, the Navy Federal Credit Union agreed with the exemption set forth by the FinCEN and urged the agency to consider expanding the exemption to include those "persons or entities appointed to represent buyers or sellers."[165]

2. The Debate about Attorney Exemptions

The most controversial topic in the ANPRM was the possibility of exempting attorneys from compliance with the anti-money laundering requirements in the real estate field. The debate focused on whether attorneys played a substantial enough role in real estate transactions to recognize money laundering activities and whether an attorney's unique position warranted infringing upon the attorney-client privilege to prevent money laundering and, perhaps, terrorist

160. RE/MAX International, Inc., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2-3 (May 27, 2003), *available at* http://www.fincen.gov/jesperson.pdf.

161. Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,571.

162. A.B.A. Section of Real Property, Probate and Trust Law, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 11-12 (June 9, 2003), *available at* http://www.fincen.gov/belcher.pdf.

163. *Id.* at 11.

164. *Id.* at 12.

165. Navy Federal Credit Union, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (June 9, 2003), *available at* http://www.fincen.gov/earner.pdf.

financing.[166] Many argued that attorneys played a key role in real estate closings and settlements and that they were usually intimately familiar with the financing and transactional details of the deal.[167] Others responded that despite the attorneys' arguably substantial role in real estate transactions, the costs of infringing upon the attorney-client privilege would far outweigh the benefits of imposing anti-money laundering requirements on attorneys.[168]

The opponents to regulating attorneys in the real estate field argued that one of the primary costs of regulation would be infringement on the attorney-client privilege, which is the oldest communication common law privilege.[169] The privilege is meant to "encourage full and frank communication between attorneys and their clients," which in turn "promotes broader public interests in the observance of law and the administration of justice."[170] According to the American Bar Association's Task Force on Gatekeeper Regulation, "the independence of the bar, the role of the lawyer as a counselor and expert in the meaning of laws, and the right to effective legal assistance form the basis for the system of justice and administration of law in the United States."[171] The United States Supreme Court has repeatedly emphasized the importance of an independent bar as a

166. The frequency and significance of the attorney's role in a real estate transaction is quite debatable, especially when in many states a lawyer's participation is not even necessary to complete a real estate transaction. As an example, attorneys only participate in residential real estate transactions approximately 40 percent of the time. Michael Braunstein, *Structural Change and Inter-Professional Competitive Advantage: An Example Drawn from Residential Real Estate Conveyancing*, 62 MO. L. REV. 241, 241 (1997).

167. *See* Requirements for Persons Involved in Real Estate Closings and Settlements, *supra* note 47, at 17,571 (recognizing that "attorneys often play a key role in real estate closings and settlements").

168. *See* A.B.A. Section of Real Property, Probate and Trust Law, Regnlatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 7-10 (June 9, 2003), *available at* http://www.fincen.gov/belcher.pdf (arguing that current safeguards of ethical rules were already in place and "imposing the Section 352 AML program requirements on lawyers would adversely affect the attorney-client privilege and would detract from the role that lawyers play in assisting members of society to understand and comply with the rule of law"); American College of Real Estate Lawyers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 7-11 (June 9, 2003), *available at* http://www.fincen.gov/weiner.pdf.

169. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

170. *Id.*; COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 8 (2002), *available at* http://www.fincen.gov/krauland.pdf; American College of Real Estate Lawyers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 9 (June 9, 2003), *available at* http://www.fincen.gov/weiner.pdf.

171. COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 6 (2002), *available at* http://www.fincen.gov/krauland.pdf.

basis for the proper functioning of the American justice system.[172] In this way, attorneys serve as "gatekeepers to the system of justice and administration of law for citizens of the United States and other countries."[173]

The American Bar Association Model Rules of Professional Conduct, as well as the ethical rules adopted by each state,[174] support the notion that "the duties of loyalty and confidentiality remain bedrock principles of the attorney-client relationship, and promote the independence of attorneys and the adversarial system."[175] The loyalty duty, described in Model Rule 1.2, requires attorneys to accept and follow the client's decisions unless the attorney knows the client's decisions are unlawful or unethical.[176] The confidentiality duty, described in Model Rule 1.6(a), with limited exception, prohibits attorneys "from revealing information relating to the representation of a client unless the client gives informed consent."[177] The comments relating to this rule further explain the trust between the attorney and the client, based on the attorney's loyalty and confidentiality:

> A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation. . . This contributes to the trust that is that hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally

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172. *See, e.g.*, Legal Services Corp. v. Velazquez, 531 U.S. 533, 545 (2001); In re Criminal Contempt of Thomas C. McConnell, 370 U.S. 230, 236 (1962); *see also* COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 6 (2002), *available at* http://www.fincen.gov/krauland.pdf (recognizing that "the independence of the bar, the role of the lawyer as a counselor and expert in the meaning of laws, and the right to effective legal assistance form the basis for the system of justice and administration of law in the United States").

173. COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 7 (2002), *available at* http://www.fincen.gov/krauland.pdf.

174. *Id.* at 6.

175. *Id.* at 7.

176. MODEL RULES OF PROF'L CONDUCT R. 1.2 (1983); *see also* COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 7 (2002), *available at* http://www.fincen.gov/krauland.pdf (stating that Model Rule 1.2 requires "the attorney to abide by the client's decisions unless the attorney knows the client's conduct is unlawful or unethical").

177. MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (1983); COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 7 (2002), *available at* http://www.fincen.gov/krauland.pdf; American College of Real Estate Lawyers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 10 (June 9, 2003), *available at* http://www.fincen.gov/weiner.pdf.

damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct.[178]

Some of the suggested requirements of the Patriot Act may infringe upon this attorney-client privilege. Strict reporting requirements of the Act could transform attorneys into quasi-government agents, potentially damaging the trust built upon the confidentiality and loyalty of the attorney-client privilege.[179] As the American College of Real Estate Lawyers noted in its Comment Letter to the FinCEN,

> Logically, a client will not consult with an attorney if the client suspects the attorney has an obligation to report the client to law enforcement authorities (e.g. in a criminal setting) or divulge the client's confidences to a counterparty (e.g. in a commercial setting). In a 1996 decision, the United States Court of Appeals for the Ninth Circuit pointedly noted "[the] valuable social service of counseling clients and bringing them into compliance with the law cannot be performed effectively if clients are scared to tell their lawyers what they are doing, for fear that their lawyers will be turned into government informants."[180]

Several other concerns arise under the proposal that Section 352 be applied to attorneys acting within the real estate sector. Insofar as the Act's suggested policies and procedures would require attorneys to investigate their clients' backgrounds, intentions, or business dealings, the Act could inappropriately interfere with the attorney-client privilege by forcing the lawyer to become adverse to his client's interests.[181] While it is appropriate for a lawyer to prepare adequately for a transaction and question the relevant facts his client presents, an attorney should not have the duty to "audit" the dealings of his client.[182] Further, under the current system, attorneys are only

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178. MODEL RULES OF PROF'L CONDUCT R. 1.6(a) cmt. 2 (1983). The attorney-client privilege, however, only allows attorneys to act as zealous advocates for their clients within ethical bounds. For example, the privilege does not apply when the "client made or received the communication with the intent to further an unlawful or fraudulent act, and the client ultimately carries out the crime or the fraud." COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 8 (2002), *available at* http://www.fincen.gov/krauland.pdf.

179. Connecticut Attorneys Title Insurance Company, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 1 (June 9, 2003), *available at* http://www.fincen.gov/hogan.pdf (noting that the implementation of Section 352 AML requirements on attorneys would convert them into "de facto government agents").

180. American College of Real Estate Lawyers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 10 (June 9, 2003), *available at* http://www.fincen.gov/weiner.pdf (quoting United States v. Chen, 99 F.3d 1495, 1500 (9th Cir. 1996)).

181. A.B.A. Section of Real Property, Probate and Trust Law, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 8 (June 9, 2003), *available at* http://www.fincen.gov/belcher.pdf.

182. Real Property, Probate & Trust Law Section of the Florida Bar, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 8 (June 9, 2003), *available at* http://www.fincen.gov/guttmann.pdf.

required to break the attorney-client privilege and report to public officials when they reasonably believe a crime might occur.[183] But the Patriot Act's expanded reporting requirements could convert lawyers into de facto government informants by requiring them also to report suspicious activity of their clients.[184] Additionally, an independent audit of the anti-money laundering program would require the auditor to examine the attorney's files, thereby breaching the confidentiality between attorney and client.[185]

Sarbanes Oxley established a heightened degree of reporting for attorneys but not to the extent proposed by the Patriot Act. Section 307 of the Sarbanes Oxley Act expanded the federal exceptions to the strict confidence of attorney-client privilege.[186] However, it did not require attorneys to investigate, audit, or conduct due diligence on their clients.[187] Rather, the law enlarged the traditional crime prevention exception to the attorney-client privilege by requiring attorneys who practiced before the SEC on behalf of public companies to report "evidence" of a "material violation" of securities laws or a "breach of fiduciary duty or similar violation" by the issuer up-the-ladder within the company to the chief legal counsel or the chief executive officer of the company. If those officers do not respond appropriately to the evidence, the attorney is required to report the evidence to the audit committee, to another committee of independent directors, or to the full board of directors.[188]

Safeguards currently in place to protect attorneys from involvement with money launderers include the rules of ethics as well as other types of reporting requirements.[189] The ethical provisions protecting attorneys include the primary exception to the Model Rules regarding attorney-client privilege and confidentiality whereby attorneys are encouraged to break confidentiality to report suspicious activity to the authorities when it would prevent a crime from

183. *Id.* at 9.

184. *Id.*

185. A.B.A. Section of Real Property, Probate and Trust Law, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate (June 9, 2003), *available at* http://www.fincen.gov/belcher.pdf.

186. National Association of Bar-Related Title Insurers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3-4 (June 9, 2003), *available at* http://www.fincen.gov/elliott.pdf (citing Securities and Exchange Commission, Implementation of Standards of Professional Conduct for Attorneys, Final Rule, 68 Fed. Reg. 6,296 (Feb. 6, 2003)).

187. *Id.*

188. *Id.*

189. COMMENTS OF THE ABA TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ON THE FINANCIAL ACTION TASK FORCE CONSULTATION 9-10 (2002), *available at* http://www.fincen.gov/krauland.pdf.

occurring.[190] Most states have adopted a similar version of this Model Rule, and "in many states, a lawyer is authorized (but not required) to disclose client misconduct when the lawyer 'reasonably believes' it necessary to avoid 'substantial injury' to the person or property of another. In four states, such disclosure is mandatory."[191] In addition, attorneys are required by federal law to report the receipt of any amount of cash over $10,000 on an IRS Form 8300. This requires the disclosure of the source of funds and whether the source is a client.[192] Finally, lawyers are also required "to report misconduct by their clients when a failure to do so would constitute fraud on a tribunal."[193]

Others argue attorneys should be exempt to avoid a duplication of efforts, delays in the closing process, and increased expenses for the client.[194] First, in those instances when real estate transactions are financed in cash, attorneys are already subject to the IRS cash reporting requirements.[195] Traditional financial institutions usually have already fulfilled some of the reporting requirements by the closing of the transaction, and when attorneys are presented with money at closing, they are required to report large payments regardless of further Patriot Act regulation:

> Most funds received by real estate attorneys come in the form of: (i) wire transfers inbound from a U.S. depository institution or from a U.S. correspondent of a non-U.S. bank; or (ii) checks or similar negotiable instruments. By the time purchasers and sellers come to the closing table they have already visited their respective banks. . .In this respect, other financial institutions who already are required under Section 352 to have AML programs in place perform basic Know Your Customer (KYC) on the customer and, if appropriate, the source of funds.[196]

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190. *Id.*

191. *Id.* at 9.

192. *Id.*

193. *Id.* at 10; *see* MODEL RULES OF PROF'L CONDUCT R. 3.3(a)(3) (requiring a lawyer who learns, during the course of a proceeding, that he or she has offered false evidence to the tribunal to take remedial measures, including disclosure if necessary).

194. Connecticut Attorneys Title Insurance Company, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3-4 (June 9, 2003), *available at* http://www.fincen.gov/hogan.pdf.

195. Real Property, Probate & Trust Law Section of the Florida Bar, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 4 (June 9, 2003), *available at* http://www.fincen.gov/guttmann.pdf.

196. Connecticut Attorneys Title Insurance Company, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3 (June 9, 2003), *available at* http://www.fincen.gov/hogan.pdf; National Association of Bar-Related Title Insurers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 6-7 (June 9, 2003), *available at* http://www.fincen.gov/elliott.pdf; Real Property Law Section of the State Bar of Georgia, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 6 (June 9, 2003), *available at* http://www.fincen.gov/iverson.pdf.

In terms of delays in the closing process, if the additional procedures were implemented for real estate transactions, "common and relatively straightforward legal transactions [could be turned] into a protracted process."[197] Finally, adding these policies and procedures, hiring compliance officers, training employees, and conducting independent audits would be expensive.[198] The significant increase in costs would ultimately fall on the consumer,[199] eventually hurting the real estate industry. This result would be extremely undesirable since the real estate industry has been one of the most economically stable industries since September 11, 2001.[200]

E. Suggestions for Implementation of Regulation on "Persons Involved in Real Estate Closings and Settlements"

Commentators offered numerous proposals regarding how to structure the implementation of anti-money laundering provisions of the Patriot Act in the real estate field, ranging from no further regulation of real estate,[201] to strict regulation similar to that already imposed upon more traditional financial institutions.[202] As previously discussed, the FinCEN must consider a variety of factors because regulating the real estate sector presents unique problems that did

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197. Connecticut Attorneys Title Insurance Company, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 3 (June 9, 2003), *available at* http://www.fincen.gov/hogan.pdf; National Association of Bar-Related Title Insurers, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 7-8 (June 9, 2003), *available at* http://www.fincen.gov/elliott.pdf; Real Property Law Section of the State Bar of Georgia, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 6-7 (June 9, 2003), *available at* http://www.fincen.gov/iverson.pdf.

198. *See* sources cited *supra* note 196.

199. *Id.*; Real Property, Probate & Trust Law Section of the Florida Bar, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 5 (June 9, 2003), *available at* http://www.fincen.gov/guttmann.pdf.

200. Dechert LLP, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (June 9, 2003), *available at* http://www.fincen.gov/kalogredis.pdf.

201. Mortgage Bankers Association of America, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 7-8 (June 6, 2003), *available at* http://www.fincen.gov/kempner.pdf.

202. *See* American Financial Services Association Consumer Mortgage Coalition, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2, 6 (June 9, 2003), *available at* http://www.fincen.gov/americanfinancial.pdf ("[T]he AML program requirements FinCEN has published for banks and broker-dealers are an appropriate model, to which the AML program requirements of persons involved in real estate closings and settlements should closely conform.").

not arise when the FinCEN implemented Section 352 on other financial institutions.[203]

IV. SOLUTION: DESIGNATION OF ONE PRIMARY PERFORMER OF ANTI-MONEY LAUNDERING PROCEDURES FROM A PRE-ARRANGED LIST OF ACTORS FOR EACH TRANSACTION

A. Closing All Possible Loopholes to Prevent Terrorist Financing

Though the risk of money laundering in real estate transactions may be lower than in other areas, the possibility of abuse does exist and this field should not remain unregulated. As at-risk areas become more heavily regulated, money launderers will search for alternative outlets for use in placing their illicit funds in the legitimate financial system.[204] Therefore, real estate could be the next target for money launderers.

B. Designating One Participant to Comply with Money Laundering Rules

In imposing Section 352 of the Patriot Act on "persons involved in real estate closings and settlements," the FinCEN should mandate the designation of a "primary compliance participant": one participant in the transaction who is responsible for complying with anti-money laundering procedures. Then, other participants in the transaction could reasonably rely on that primary participant's completion of the procedures. Although the number, identity, and role of participants in real estate transactions vary,[205] an established order of designees as primary compliance participants would be the most effective means of deciding which party bears the burden of compliance. This system would also limit the possibility of neglecting to designate someone as primary compliance participant and prevent drawn-out negotiations regarding who should shoulder the responsibility.

This system would also be the most effective way to avoid duplicative efforts, to minimize costs that would eventually transfer to the client, and to maintain the economic stability of the real estate field. In essence, it would be the least cost avoidance solution. By

203. *See* discussion *infra* Part III.A.

204. Gregory, *supra* note 11, at 27-30 (evidencing that money launderers structured their deals to avoid the $10,000 reporting requirement and then began taking advantage of foreign banks when U.S. laws took a stronger approach in eliminating the problem).

205. *See generally* 15 POWELL ON REAL PROPERTY § 84C.01 (2004).

placing the burden of compliance with one participant in the transaction, duplicative due diligence efforts would not be required.

C. Deciding Which Participant to Designate

The most complicated aspect of implementation would involve determining who is in the best position to fill the role as primary compliance participant. FinCEN should codify a list, which would dictate the order in every real estate transaction. The first entity or person on the list should be selected to be primarily responsible for compliance, unless that entity or person is not a participant in the particular transaction. If the latter is the case, then one would move down the list until reaching a person or entity involved in the transaction.[206]

First on the list should be banks and other traditional financial institutions. These institutions are uniquely suited to investigate clients' backgrounds, are distinctively familiar with the details of the transactions, and are already subject to the compliance regulations.[207] Since they are already required to comply with the anti-money laundering provisions of the Patriot Act, it would not make sense for someone else involved in the transaction to duplicate their efforts. Furthermore, traditional financial institutions would be in a particularly appropriate position to fill the role of primary compliance participants because they are involved in most real estate transactions.

Title insurance companies should be second on the list to bear the responsibility of compliance. They are involved in a significant

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206. The list was compiled as simply as possible, but it is not always clear which parties are involved in real estate transactions. Although title insurance companies are identified separately from escrow agents, there are transactions where those roles would be played by the same individual or company. Further, in many situations, multiple brokers would be involved, including a listing agent broker, broker for the seller who finds the purchaser, and the buyer's broker; therefore, a specific order amongst those participating parties would also need to be established to avoid ambiguity in the line of duty.

207. *See* American College of Mortgage Attorneys, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2-3 (June 6, 2003), *available at* http://www.fincen.gov/bromberg.pdf (arguing that it would be more sensible to "impose the requirements of the proposed rule only on those 'financial institutions' that are customarily and directly involved in providing or handling funds at commercial real estate purchase and financing transactions," and "most of these loans involved funding by financial institutions that are already subject to anti-laundering and related governmental scrutiny and reporting requirements"). *Cf.* Navy Federal Credit Union, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 1 (June 9, 2003), *available at* http://www.fincen.gov/earner.pdf (pointing out the lender's unique ability "to identify potential borrower abuses" because of its review in determining the individual's credit worthiness).

number of real estate transactions and would be better able to bear the costs than the escrow agent.[208] Although title insurance companies usually only investigate information contained in public records, under these new regulations, they would be required to institute anti-money laundering programs as well to conduct further due diligence on the client.[209] Admittedly, this would be rather costly. Those costs, however, would ultimately fall upon the client, regardless of who is charging for them.

Escrow agents are the next best positioned to act as primary compliance participants. They are responsible for the funds in a real estate transaction and would therefore already be familiar with the financial details of the transaction.

Fourth in line should be real estate brokers and agents. These parties know the client and possibly the sources of financing, and would be able to implement procedures to further investigate the entire transaction and the seller.[210]

As a last resort, attorneys should bear the responsibility for compliance. Although attorneys are usually knowledgeable regarding the details of the transaction, an exception to the strict confidentiality of attorney-client privilege should be made only on rare occasions. By keeping attorneys at the end of the line, the attorney-client privilege, a cornerstone of American justice, remains duly protected. Attorneys should not be exempted from this process altogether because they do possess important information regarding the deal and the clients; if this system is to be effective, all gaps and loopholes must be closed from money launderers and terrorists.

Finally, if none of these key entities or people are involved in a given real estate transaction, the burden of compliance should remain on all involved parties. In order to ensure compliance, the government should also implement a penalty or strict fine system to penalize parties for failure to comply. The penalty should be higher for the primarily responsible party but should be shared among all parties

208. *See* Escrow Institute of California, Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 9 (June 9, 2003), *available at* http://www.fincen.gov/pothier.pdf ("[S]ettlement agents are already subject to reporting requirements on cash transactions . . . [and] to also impose additional rules on the escrow companies, who primarily are composed of small businesses and who do not participate in structuring the real estate deals, will result in higher costs to the consumers without a reasonable expectation that money laundering will be detected or prevented.").

209. Attorneys' Title Guaranty Fund, Inc., Regulatory Comment on the Advanced Notice of Proposed Rulemaking for Section 352 as Applied to Real Estate, at 2 (June 9, 2003), *available at* http://www.fincen.gov/birnbaum.pdf.

210. As many as three brokers could be involved in any one real estate transaction, including the listing agent, the seller's broker, and the buyer's broker; the FinCEN could do further research to determine which of those parties could most effectively bear the compliance burden.

involved in the transaction because ultimately, all parties are responsible for ensuring compliance.

D. How to Comply

In order to comply with the Patriot Act, the parties to a real estate transaction would follow the requirements in the FinCEN's regulation. First, those involved must determine which party should be responsible for compliance with anti-money laundering procedures. After designating a primary compliance participant from the above list, the remaining parties would sign an agreement indicating their reasonable reliance on the designee's effective and proper compliance with the anti-money laundering provisions.[211] This agreement would ensure that the primary compliance participant would recognize and be reminded of its duty, and it would allow the other parties to recognize that, for this transaction, they do not need to perform those duties. It would also be reasonable for the others to rely on the primary designee's performance of those duties after this agreement was signed.

The Patriot Act requires that each financial institution establish, at a minimum, certain internal policies and procedures to protect itself against money laundering.[212] Designation of a compliance officer, organization of an employee training program, and an independent audit function ensure the programs are effective.[213] In establishing internal policies and procedures, it is extremely important for the financial institution to ensure that it is "not doing business with any person, entity or group (including officers, directors, partners, members with 25 percent or more ownership interest) listed as a terrorist or terrorist entity on the SDN [Specially Designated Nationals] list."[214]

Application of this provision to the real estate sector dictates that the most effective way to ensure that the financial institution avoids doing business with anyone on the list is for the designated compliance officer of the primarily responsible party in the real estate

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211. This agreement is similar to the written confirmation of due diligence suggested in Kevin L. 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, 437-38 (2004).

212. Patriot Act, *supra* note 7, §§ 352(a)(1)(A)-(D).

213. *Id.*

214. Tara K. Gorman, *Do You Look Good in Prison Stripes? USA PATRIOT Act and Anti-Terrorism Laws - Real Estate Industry: Stand Up and Take Notice*, PROP. WRITES, Oct. 5, 2004, at 8, *available at* http://www.hklaw.com/Publications/Newsletters.asp?IssueID=504&Article=2739.

transaction to utilize a computer software program that tracks names on the SDN list.[215] If the program recognizes one of the party names as suspicious, the party responsible for compliance should conduct further due diligence to determine whether it was a SDN list "hit", what the quality of the "hit" was, and how much other information regarding the party matches the information of the SDN listed party.[216] If the party matches the listed party, then the compliance officer should report the information to the Treasury's Office of Foreign Assets Control ("OFAC") Compliance Programs Division.[217]

To meet the other requirements of the statute, all parties in the real estate transaction would be required to establish ongoing employee training programs and independent audit functions. The financial institution would need to provide its employees with an overview of money laundering, including instruction on how to detect suspicious activity and how to avoid being drawn into the situation. The financial institution should continue this training as warranted by new development in techniques to avoid money laundering. Finally, the financial institutions involved in real estate transactions would need to hire an independent auditor who would periodically ensure that the regulations are being effectively implemented.

Some of the penalties for noncompliance with Executive Order 13224 and OFAC regulations are rather harsh.[218] The penalties should be fine-tuned to ensure that the Patriot Act is implemented most effectively in the real estate sector. Currently, willful violations carry "fines of $25,000 per day civilly or up to $250,000 per day for a willful criminal violation," and, "[a] company can also be criminally liable for up to $500,000 for willful violations of the Act if the company is involved in a pattern of illegal activity involving more than $100,000."[219] The Patriot Act also increased the opportunity for enforcement through the use of "civil and/or criminal penalties for violations of the due diligence requirements for the United States private banking and correspondent accounts (previously covered by the BSA) to 'not less than two times the amount of the [illegal] transaction, but not more than $1,000,000.'"[220]

Financial institutions would also continue to be protected by the safe harbor provisions for suspicious activity reporting that were

215. *Id.*

216. *Id.*

217. *Id.* at 8-9.

218. *Id.* at 9.

219. Steptoe & Johnson LLP, The USA PATRIOT Act and Financial Institutions, http://www.steptoe.com/publications/PI3052.pdf (last visited Oct. 24, 2005).

220. *Id.*

first enacted in 1992 and later incorporated into the FinCEN.[221] Recently, "several courts have disagreed about the scope of the protection afforded by this safe harbor provision," but a May 2004 interagency advisory report recognized that a majority of courts have ruled that "the safe harbor provision provides unqualified protection to financial institutions and their employees from civil liability for filing a SAR [suspicious activity report]."[222] The report delineated that

> communicating with law enforcement authorities through these processes, or in response to a subpoena from federal, state, or local law enforcement agencies or other forms of compulsory process, such as a request from FinCEN pursuant to section 314(a) of the USA PATRIOT Act or the reporting of a blocked transaction to the U.S. Department of the Treasury's Office of Foreign Assets Control, will provide maximum legal protection for financial institutions.[223]

This same kind of maximum legal protection extended to financial institutions in filing suspicious activity reports should extend to the real estate field and the parties who file these reports.

E. Costs and Benefits of Proposal

Imposing the anti-money laundering programs on all parties involved in real estate transactions would facilitate the education of all parties, enable them to better recognize suspicious activity, and effectively prevent money laundering. Accordingly, the definition of "persons involved in real estate transactions and settlements" should include all parties involved, or potentially involved, in real estate transactions, settlements and closings, including banks and other financial institutions, title insurance companies, real estate brokers and agents, buyers and sellers, attorneys, and escrow agents. Real estate actors generally not involved in closings, including appraisers, surveyors, and title abstractors, should be exempted.

No system will be able to perfectly implement the Patriot Act in the real estate field, but this proposed solution represents the least-cost avoidance option. Although this proposal requires everyone involved in real estate closings and settlements to comply with the anti-money laundering procedures, compliance with these programs would not be as expensive as might be projected because they would not be used frequently by most parties. Although the proposed

221. FDIC, Federal Court Reaffirms Protections for Financial Institutions Filing Suspicious Activity Reports, http://www.fdic.gov/news/news/financial/2004/fil6704a.html (last visited Oct. 24, 2005).

222. *Id.*

223. *Id.*

solution would require training for all involved in real estate transactions, the costs would most likely be offset or outweighed by the benefits of preventing money laundering in real estate. Despite being required to hire a compliance officer or independent auditor, that person would need to act infrequently because most likely, this duty would fall on traditional financial institutions that already have to perform these duties under existing law.

Some might argue that it would not be possible to recognize whether this regulation was in fact effective in inhibiting terrorist financing because of the difficulty in determining the actual size and roots of the money laundering problem. However, it is important to recognize that money laundering is a significant problem in this country and real estate remains vulnerable to the crime.[224]

Others might argue that it would result in the overregulation of banks. Although banks are already highly regulated and therefore might oppose heavier regulation, there would not be significantly higher costs to implementing this system because banks are already required to do the same kind of due diligence and research on the transaction.[225]

Others cite the growing mounds of paperwork accumulating on regulators' desks because of the Patriot Act as a reason not to impose the regulation on all parties to a real estate transaction.[226] This paperwork, however, is necessary if the government is to impose stricter regulations on the field.

Although many would argue it would be more effective to move lawyers further up the line of responsibility, it is important to recognize the importance of protecting the attorney-client privilege, as well as the sporadic involvement of attorneys in real estate transactions.[227] The necessity of attorney participation in real estate

224. Financial Crimes Enforcement Network, About FinCEN/FAQs, bttp://www.fincen.gov/af_faqs.html (last visited Oct. 24, 2005); *see also* discussion *infra* Part II.A.

225. *See* John J. Byrne & Michael D. Kelsey, *USA PATRIOT Act: What a Long Trip It Has Been*, *available at* http://www.aba.com/NR/rdonlyres/201ED198-10FC-4328-A9E870E2509549A2/37221/CoverStory.pdf (discussing the effects of the implementation of the Patriot Act on the banking industry).

226. Opponents of the Patriot Act have argued that it may cause important information to be overlooked because of the sheer volume of documentation that is now required. *See* John Berlaw, *Show Us Your Money: The USA PATRIOT Act Lets the Feds Spy on Your Finances. But Does it Help Catch Terrorists?*, REASON, Nov. 2003, *available at* http://www.reason.com/0311/fe.jb.show.shtml.

227. *See* Braunstein, *supra* note 166, at 241 (arguing that "lawyers have become marginalized in the residential real estate transaction"); *see also* Alice M. Noble-Allgire, *Attorney Approval Clauses in Residential Real Estate Contracts – Is Half a Loaf Better than None?*, 48 KAN. L. REV. 339, 339 (2000) ("Yet, for the majority of residential real estate transactions today,

transactions has been debated for years, and the majority of states have chosen not to require attorney participation in residential real estate transactions.[228] Lawyers are only involved in about 40 percent of residential real estate transactions,[229] which reveals that their responsibility for compliance will arise less than half of the time. Thus, in most instances, it would not be effective to expect the lawyer to be responsible for compliance with the anti-money laundering procedures.[230] The other parties listed earlier in priority on the list will more likely be involved in the transaction.

Also, frequently there is limited or no communication between parties to a transaction, which makes implementation of the proposal difficult.[231] In order to combat this problem, the primarily responsible party would need to communicate early in the transaction[232] with each party to ensure the compliance was completed.[233]

Another difficulty that might arise in implementing the proposed solution is that fields which have not historically been heavily regulated, like title insurance, real estate brokerage, escrow agency, and the law, might object to being policed in this way. The FinCEN should analyze the effect of increased regulation to determine

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fewer and fewer lawyers are being employed early in tbe process to advise and protect the parties from these perils.").

228. *See* Tara Austin, *Legal Professionalism:* Doe v. McMaster *and the Lawyer's Role in Real Estate*, 55 S.C. L. REV. 591, 591 (2004) ("Many jurisdictions have pondered the topic, and most courts have been less hostile to the idea of nonlawyers conducting real estate closings than the courts of South Carolina."). South Carolina requires the presence of an attorney at real estate closings through statutes, conduct rules, and common law. *Id.* New York also requires that an attorney prepare "deeds, mortgages or any other instruments affecting real estate." REAL ESTATE BROKERAGE LAW AND PRACTICE § 7.04 (Matthew Bender & Co., 2004). Yet, Arizona implemented a constitutional amendment that allows real estate brokers to draft instruments used in real estate transactions. *Id.* Finally, Washington has taken a more unique approach through "Rule 12," which was established in 1983 and created a new group of lay practitioners, referred to as closing officers, who are able to "select, prepare and complete certain legal documents incident to the closing of real estate transactions." *Id.*

229. Braunstein, *supra* note 166, at 241.

230. *See id.* at 241 (evidencing that "lawyers have become marginalized in the residential real estate transaction"); *see also* Noble-Allgire, *supra* note 227, at 339 ("Yet, for the majority of residential real estate transactions today, fewer and fewer lawyers are being employed early in the process to advise and protect the parties from these perils.").

231. Closings can either occur face-to-face or through escrow by which the parties do not have to meet face-to-face. The face-to-face or "table" closings occur more frequently in the eastern states, while the escrow closings are more popular in California and other western states. *See* Joan H. Story, REAL ESTATE LAW AND PRACTICE COURSE HANDBOOK SERIES 9, 28-29 (Practicing Law Institute 2000).

232. This time period could be set by the FinCEN after doing some research to determine a reasonable amount of time in regard to how long is generally spent preparing for real estate transactions.

233. The details of how this communication would need to occur should be determined by the FinCEN in establishing a regulation and are outside the scope of this Note.

which federal agencies would be best qualified to regulate these under-regulated areas. In doing so, it should take into account the costs imposed on the regulator and the additional manpower necessary to shoulder that burden.

Finally, despite the increased cost of implementing the anti-money laundering program across the board in real estate, the nature of the crime necessitates undertaking these measures. It is important that no one is exempted from the definition because terrorists will target this group. Such a result would defeat the purpose of implementing the program.

V. CONCLUSION

The Patriot Act is one of the most comprehensive efforts to eliminate terrorist financing through anti-money laundering provisions.[234] The implementation of the Act upon financial institutions reinforced President George W. Bush's resolute comments on September 11, 2001: "Terrorist acts can shake the foundations of our biggest buildings, but they cannot touch the foundation of America. These acts shatter steel but they cannot dent the steel of American resolve."[235] Although real estate transactions have remained temporarily exempted from implementation since the enactment of the law, these anti-money laundering requirements will be imposed upon "persons involved in real estate closings and settlements." In the war against terror, it is important that no sector of American business remains vulnerable to terrorist financing.

Although many would argue that the implementation of strict requirements on the real estate sector would cost more than the benefits reaped, the short-term costs pale in comparison to the extraordinary cost – both in lives and in dollars – of future large scale terrorist attacks. While the ANPRM received varying comments regarding the application of the proposed rule to real estate, one common theme remained: the almost unanimous support for the

234. *See* John W. Snow, *Blood Money*, WALL ST. J., Apr. 23, 2004, at A14 (explaining that "one of the most critical things the 9/11 Commission hearings have brought to light is the important role the Patriot Act plays in helping to win the war on terror. We have heard a lot about 'the wall' - a conceptual barrier that prohibited agencies such as the FBI and CIA from communicating freely with each other. That wall was knocked down when President Bush signed the Patriot Act in October 2001").

235. President George W. Bush, Address to the Nation Following Alleged Terrorist Attacks on New York and Washington, D.C. (Sept. 11, 2001), *available at* http://www.pbs.org /newshour/bb/military/terroristattack/bush_speech.html.

Administration's efforts to prevent, prohibit, and cut off terrorists' sources of funding.[236]

Since the real estate sector remains vulnerable to abuse by money launderers,[237] the field must not go unregulated. Although real estate might not be the most effective way for money launderers to legitimize their funds, it will likely become a more appealing outlet to money launderers as recent regulation has completely blocked many other outlets. In order to successfully fulfill the Patriot Act's goal of deterring and punishing "terrorist acts in the United States and around the world,"[238] no channel should remain available for use by money launderers.

Implementing the anti-money laundering standards upon the real estate sector forces the FinCEN to deal with many complicated and controversial issues. The most effective way to structure the implementation is to require one primary participant from an ordered list to bear the responsibility for compliance, while allowing others to reasonably rely on the designee's efforts to comply with the anti-money laundering requirements. This entire process would become more effective and less costly with time, as those involved became educated on the subject and accustomed to performing the routine prevention of money laundering procedures during a real estate transaction. In the end, the mild renovation of the system would be more than worthwhile in protecting the United States from further terrorist attacks and the horrifying loss of life.

Elizabeth A. Cheney *

236. *See* sources cited *supra* note 16.

237. *See* discussion *supra* Part III.B.

238. Patriot Act, *supra* note 7, § 302.

* J.D. Candidate, May 2006, Vanderbilt University Law School. I would like to thank my parents, Susan and Andrew Cheney, for their support and encouragement throughout the note-writing process; Professor Jon Bruce, Professor Ralph W. Davis, and Professor Nancy King for their valuable input; the law review staff members who spent many hours assisting me in the editing process; and the many others who offered indispensable advice during this entire endeavor.

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Racial Integration and Community Revitalization: Applying the Fair Housing Act to the Low Income Housing Tax Credit

Myron Orfield *58 Vand. L. Rev. 1747 (2005)*

At the heart of a debate about the future of American race, housing, and urban policy are two important lawsuits recently filed in state courts in New Jersey and Connecticut. Plaintiffs challenge the authority of their respective state housing finance agencies to fund subsidized units, with U.S. Treasury issued tax credits, in neighborhoods of racial and social isolation. These cases seek clarification of the Fair Housing Act of 1968 (Title VIII), parallel state fair housing provisions, the equal protection clauses of state and federal constitutions, and the meaning of the two most important state fair housing cases ever decided. On a broader policy level, the litigation highlights critical differences between civil rights advocates and regionalists on one side and many practitioners of community development and urban political leaders on the other. Civil rights forces see racial segregation, and the integrally related concentration of poverty, in the housing market at the core of the problem of individual opportunity and urban redevelopment in America. They argue that building and rebuilding low-income housing in the poorest neighborhoods deepens—or at least makes permanent—racial and economic barriers between individuals and metropolitan communities. Community development forces argue that the building and rebuilding of low-income housing in poor segregated neighborhoods must continue and is the only way, within the existing political context, to revitalize these places. Further, they would argue that civil rights concerns are not applicable to the allocation of tax credits, and even more importantly Congress actually gives preference in statute to using these tax credits in densely poor segregated neighborhoods. The outcome of these cases, and the broader resolution of these policy conflicts, could mark an important turning point in U.S. civil rights law and housing and urban policy.

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