American Financial Services Association
Consumer Mortgage Coalition

June 9, 2003

Financial Crimes Enforcement Network
Department of the Treasury
PO Box 39
Vienna, VA 22183

Re: Section 352 -- Real Estate Settlements

Dear Sirs:

The Consumer Mortgage Coalition ("CMC") and the American Financial Services Association ("AFSA") appreciate the opportunity to comment on the advance notice of proposed rulemaking (the "ANPR") that the Financial Crimes Enforcement Network ("FinCEN") recently issued,[1] soliciting answers to four questions concerning the requirement that "persons involved in real estate closings and settlements" implement anti-money laundering programs.[2] For the reasons discussed below, our answers are as follows:

1. *What are the money laundering risks in real estate closings and settlements?* The primary money laundering risks arising out of the purchase of real estate are associated with the placement and integration of illicit funds. These risks arise when legal title to real property transfers for valuable consideration, not when title transfers pursuant to gift or devise, and not when title transfers as an insignificant part of a commercial transaction such as the sale of the assets of a business.

2. *How should persons involved in real estate closings and settlements be defined?* "Persons involved in real estate closings and settlements" should be defined to exclude most persons arguably "involved" in the purchase transaction and to include only the person that disburses valuable consideration on behalf of the purchaser of real property in any covered closing or settlement. Ordinarily, this will be the settlement attorney, settlement agent or escrow company, but the definition should be based on function rather than on possession of a particular license or use of a particular nominal job description.

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1 69 Fed. Reg. 17569-17571 (April 10, 2003).

2 This requirement is imposed by Section 352(a) of the USA PATRIOT Act, Pub. L. 107-56, amending 31 U.S.C. 5318(h). *See* 31 U.S.C. 5318(h)(1) (financial institutions must implement anti-money laundering programs), 5312(a)(1)(U) (definition of "financial institution" includes "persons involved in real estate closings and settlements").

3. *Should any persons involved in real estate closings or settlements be exempted from coverage under Section 352?* Persons otherwise subject to Section 352 should be exempted from coverage under the rule that emerges from this ANPR. This exemption should include both persons already clearly subject to existing final rules applying Section 352 to other categories of financial institutions, and during a transitional period to persons that reasonably expect to be subject to Section 352 rules yet to be published.

4. *How should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?* FinCEN has done a good job of developing anti-money laundering ("AML") program requirements for other categories of financial institutions that balance the need for specific goals with the need to provide individual institutions the flexibility to address their own particular circumstances appropriately. The AML program requirements that emerge from this ANPR should be the same as those already applied to other financial institutions.

In addition, we think that FinCEN should provide that persons subject to the AML program requirements that emerge from this ANPR be able to reasonably rely on other financial institutions subject to such requirements that provide such AML services to such persons pursuant to contract.

Real Estate Settlements and Money Laundering Risks

CMC is a trade association of large, national mortgage lenders, servicers and service providers. AFSA is the national trade association for market-funded providers of financial services, including mortgage and home equity loans, to consumers and small businesses. Both of our organizations have long championed appropriate regulation of the mortgage lending industry. As you are well aware, the consummation of a mortgage loan and the transfer of real property are often both referred to as "closings" or "settlements," and regulations affecting one often have an impact on the other. We have a strong interest in seeing that the AML rule for real estate closings is coordinated with AML rules for lenders – both the existing AML program requirements for banks and the anticipated AML rule for loan and finance companies – rather than imposing inappropriate regulatory requirements that burden real estate-related transactions generally.

We therefore think it important that an AML rule for real estate closings be limited to real estate *purchase* transactions, not real estate *finance* transactions. Although the two often go together, they do not necessarily: real estate is sometimes purchased for cash, and both refinancing an existing mortgage loan and obtaining home equity credit do not involve any purchase. While there is some overlap in purchase-money mortgage transactions, on the whole, different sets of persons are involved in the two types of transactions, they perform different activities, and, most important for the present discussion, the anti-money laundering strategies appropriate to one are not necessarily applicable to the other. In a finance transaction, it is important for anti-money laundering purposes to know where the money is going. In a purchase transaction, it is equally if not more important to know where the money is coming from. Knowing where the money is going means figuring out who the *borrower* is in a finance transaction, but figuring out who the *seller* is in a purchase transaction – which is quite another thing. Indeed, there are a whole series of questions pertaining to the seller in a purchase transaction that are not only largely irrelevant

in a finance transaction but difficult for a lender to answer. The "red flags" identified by the American Land Title Association ("ALTA"), some of which FinCEN has reproduced in the ANPR, include examples of the sort of issues that can and should prompt questions about sellers of real estate, but that rarely arise in the context of real estate finance. We therefore think FinCEN should make clear that the AML rule for persons involved in real estate closings and settlements will apply only to "closings and settlements" in which real property is purchased, that is, in which legal title to real property changes hands.[3]

Nor do we think that all transfers of legal title should be covered by this AML program requirement, given the limitations of real estate purchase transactions as a method of laundering money. Transfers of legal title in general are not good vehicles for layering illicit funds. While such transfers may introduce layers of ownership between some initial placement of the funds and some ultimate integration of those funds, each of those layers must be publicly recorded for the ultimate integration to be possible: integration is not complete until a bona fide purchaser exchanges untainted funds for the tainted asset, and no bona fide purchaser will buy real property that does not have a clear chain of title. The need for this paper trail utterly defeats the purpose of the layering. It is thus clear that real estate purchase transactions are of use only in the placement and integration of tainted funds. But this means that imposing AML obligations in connection with some transfers of legal title is effectively valueless for the fight against money-laundering.

A transfer of legal title for no consideration or nominal consideration does not appear to us to pose risks even in connection with the placement or integration stages of money laundering. A transfer without negotiable consideration neither places nor integrates illicit funds. Releasing such transfers from the AML obligation therefore does not sacrifice any of the scrutiny that Congress intended USA PATRIOT to require. At the same time, because such transfers typically occur between family members or in connection with the settlement of the estate of a deceased owner, not requiring AML programs in connection with such transfers minimizes the intrusiveness of the USA PATRIOT obligations into the private lives of individuals.

For somewhat different reasons, we also think that a transfer of legal title to real estate in a commercial transaction where real estate does not constitute a significant part of a commercial transaction – for example, a transfer in connection with the sale of substantially all the assets of a non-real estate business – should not be covered by this AML program requirement. Commercial transactions typically are complex and involve a number of persons already subject to AML program requirements, such as banks and securities broker-dealers. Because such a transaction is likely to be subject to AML scrutiny from other angles, it would be redundant and potentially misleading to subject it to AML scrutiny from the real estate angle if real estate

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[3] FinCEN has suggested that transactions in which rights to the use of real property transfer but legal title does not, such as "under a lease agreement," may be appropriate subjects for this rule. 68 Fed. Reg. 17570. We respectfully disagree. Congress' use of the term "real estate closings and settlements," a phrase not generally associated with the negotiation of leases or other transfers of use rights, indicates that Congress did not intend to grant FinCEN the authority under this definition of "financial institutions" to regulate lease transactions or similar transactions. If FinCEN wishes to regulate lease transactions, we submit that it is only appropriate to do so under FinCEN's residual authority to designate "any other business … whose cash transactions have a high degree of usefulness in criminal, tax, or regulatory matters" as a "financial institution" for purposes of the Bank Secrecy Act in general, and the AML program requirement in particular. *See* 31 U.S.C. 5312(a)(2)(Z).

formed a minor component of the transaction. Limiting the applicability of the rule to commercial transactions that really need this sort of scrutiny maximizes its value and minimizes its intrusion into ordinary business practices.

CMC and AFSA therefore think that a "real estate closing or settlement" should be defined as something like "the consummation of (i) a consumer transaction in which legal title to real property is transferred for non-nominal consideration having objective value, or (ii) a commercial transaction in which the transfer of legal title to real property constitutes a significant part of the transaction."

Persons Involved in Real Estate Closings

The same considerations – that real estate-related regulatory requirements be appropriate, and that AML programs be crafted to produce the maximum effectiveness consistent with limited intrusion into ordinary consumer and business practices – strongly suggest to us that the vast majority of persons "involved" in real estate closings not be subject to this AML program requirement. FinCEN has suggested that a residential real estate transfer could "involve" for the purposes of AML obligations all of the participants in the transaction listed on the HUD-1 form.[4] As a preliminary matter, we should point out that the HUD-1 is required in connection with a real estate finance transaction, which as we have noted above is quite different from a real estate purchase transaction. In addition, imposing AML obligations on most of the participants listed on the HUD-1 is self-evidently either redundant or valueless:

- The lender is already covered by an AML program requirement of its own if it is a depository institution,[5] and if it is a non-depository lender then it is likely that it will be covered by the AML program requirement applicable to "loan and finance companies" ultimately published by FinCEN.
- The mortgage broker, if the transaction involves one, will also probably be covered by the AML program requirements for "loan and finance companies."
- The mortgage insurer, if there is one, is engaged in providing a type of insurance that FinCEN has already indicated is not of money laundering concern.[6] We see no reason why an activity that does not require AML scrutiny in general should suddenly require such scrutiny merely because it is tangentially associated with a real estate purchase.
- Other persons listed on the HUD-1, such as the providers of flood certification, tax certification, title search, document preparation and courier services, work for other participants in the transaction – usually the lender – and have no independent knowledge or perspective from which to undertake meaningful AML activities. The bank AML program requirement does not cover check printers, and the proposed insurance AML program requirement does not cover physicians that administer life insurance physicals.

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4 68 Fed. Reg. 17570, note 8.

5 31 C.F.R. 103.120.

6 *See* 67 Fed. Reg. 60630 (September 26, 2002) (proposed 31 C.F.R. 103.137(a)(2)).

> There is no reason for the real estate closings AML program requirement to apply to providers of ancillary services to real estate lenders.[7]

Of all the persons arguably "involved in" the closing of a real estate purchase, whether or not listed on the HUD-1 form, we think only the settlement agent or escrow agent is both free from other AML obligations and possessed of independent knowledge that may be of interest in the AML context. As we have noted above, real estate sales are of value to money launderers primarily as vehicles for placement and integration of illicit funds. Knowing *both* where the purchase funds are coming from *and* where they are going is critical in determining whether a particular real estate purchase raises suspicions of placement or integration. The settlement agent, who actually receives and disburses the purchase funds, has precisely that information, and it is appropriate that the settlement agent should analyze the information for AML considerations. It is distinctly possible that no other AML programs will apply to a settlement agent that is often an attorney in private practice or a small business, and so it is imperative that the AML program requirement for persons involved in real estate closings and settlements do so, in order that potentially valuable information not be lost.

As FinCEN has noted, however, the settlement mechanism varies significantly from place to place, influenced by divergent state laws and local customs. This variety is even greater when both commercial real estate purchases and non-commercial real estate purchases that are not financed by mortgage loans are taken into account, as our proposed definition would do. Some transactions will involve one sort of intermediary, some will involve another, and some may involve no formal intermediary at all but nevertheless have a person functioning in that capacity. We therefore think that it is not feasible to identify certain regulatory categories as those to which this AML obligation should apply. Rather, "settlement agents" should be defined functionally. In an earlier letter, the CMC and AFSA, together with the Mortgage Bankers Association of America, urged FinCEN to impose AML obligations as much as possible with reference to specified financial activities, rather than particular categories of institutions. In this case, we think such an approach is not merely desirable but unavoidable. FinCEN should define a "person involved in a real estate closing or settlement" as something like "that person, if any, that (i) receives funds or other assets, constituting the consideration for the purchase of real property, from the purchaser of such real property, and (ii) disburses such funds or other assets from or on behalf of the purchaser and to or on behalf of the seller, and (iii) is responsible for effecting the exchange of consideration and the transfer of legal title to real property."

Exemptions from Coverage

If this rule covers financial institutions defined functionally, however, while other AML program requirements are imposed on financial institutions defined structurally (possessing bank charters, broker-dealer registrations or investment company registrations, for example), the possibility of multiple, overlapping AML requirements applying to a single institution is great. In order to avoid possible confusion and undue regulatory burdens arising out of such overlap, the rule should contain an exemption for persons that happen to fit the definition of "persons involved in

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[7] The same considerations apply with even greater force to persons who may not be listed on the HUD-1, but who perform evaluation services, such as property inspection or termite inspection, to prospective purchasers.

real estate closings and settlements" but are already subject to AML requirements under another rule.

FinCEN must be careful, however, not to allow such an exemption to create competitive imbalances among financial institutions. Real estate lenders often take on many responsibilities in connection with real estate purchase transactions that are partly or completely financed, and thus it is real estate lenders that are at the greatest risk of being subject to overlapping AML requirements. But providing an exemption such as outlined above only benefits some real estate lenders – principally the depository institutions – while non-bank mortgage lenders would remain subject to the rule even though most of them anticipate that AML program requirements will eventually apply to them as "loan and finance companies" and are taking compliance steps accordingly. The latter institutions should not be penalized for their anticipation of, and diligence in planning for, forthcoming regulatory requirements. In order to avoid creating an uneven regulatory playing field, FinCEN should also exempt from this AML program requirement any person that reasonably expects to be subject to a comparable AML program requirement and has taken anticipatory steps to comply with such a requirement.

Specifics of the Anti-Money Laundering Program Requirement

Competitive considerations also require that the underlying AML program requirements be substantially the same from one type of financial institution to another. If a bank acts as a settlement agent in one transaction, it should not be subject to substantially different requirements than an attorney acting as a settlement agent in another transaction. On the whole, we think that the 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.

Reliance on Other Financial Institutions

One additional factor will be very important in making the AML program requirement for persons involved in real estate closings successful, and that will be permitting financial institutions subject to the requirement to rely on other financial institutions for AML compliance where reasonable. Real estate transactions are relatively complex, directly or indirectly involving a number of independent parties. In addition, as we have noted, by virtue of the specific parties participating, or because the purchase is coupled with a financing transaction covered under another rule, a single real estate purchase may well be covered under multiple, overlapping AML programs. And yet, the purchase is a single transaction, with a single set of facts for which a single, effective AML analysis should be sufficient. Under these circumstances, it is eminently reasonable that, if one financial institution undertakes an AML analysis of a particular real estate purchase transactions, other financial institutions with analogous responsibilities should be able to rely on that analysis. FinCEN has already established that one financial institution can reasonably rely on the customer identity verification program of another – although we are disappointed that this reliance is unjustifiably limited to financial institutions subject to federal functional regulators.[8] With real estate closings and settlements, FinCEN has a perfect opportunity to expand the scope of its concept of reasonable

[8] *See* 31 C.F.R. 103.121(b)(6).

reliance, permitting the financial services industry to coordinate its AML activities, producing better information, fewer redundant reports and less reporting noise at lower cost to the industry and ultimately to consumers.

While we advocated this coordinated approach as early as our letter of last year, federal regulatory developments cause us to repeat our request now with greater urgency. The Department of Housing and Urban Development has proposed modifications to the Real Estate Settlement Procedures Act rules that would strongly encourage the bundling of settlement services in real estate finance transactions.[9] This will inevitably increase pressures to coordinate the provision of settlement services, and it will magnify the relative harm caused by those remaining regulatory requirements that run counter to the coordination trend. If increased anti-money laundering vigilance can be achieved without having AML program requirements stand as an obstacle to the achievement of other regulatory goals and consumer benefits, the financial services industry will be more enthusiastic about taking up its AML responsibilities, consumers will be more supportive, and the USA PATRIOT Act will have achieved its underlying goal of increasing the security of the American financial system without unduly burdening it in the process. We therefore strongly urge FinCEN to permit financial institutions – including those not subject to a federal functional regulator, as many settlement agents will not be – to rely on other financial institutions involved in real estate closings for AML compliance if such compliance is reasonable and pursuant to contract.

In conclusion, we would like to reaffirm the commitment of the CMC, AFSA, and all of our members to waging a vigorous fight against money laundering and terrorist finance. We hope that our comments help FinCEN to develop the appropriate, effective USA PATRIOT regulations that will coordinate that effort. If we can provide any additional information, please do not hesitate to call Anne C. Canfield, CMC's Executive Director, at (202 544-3550), or Monique Gaw, AFSA's Vice President for Federal Government Relations, at (202) 296-5544.

American Financial Services Association

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[9] *See* Department of Housing and Urban Development. Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers. 67 Fed. Reg. 49133-49174 (July 29, 2002).