34 Iverson

June 9, 2003

BY E-MAIL

ATTN: Section 352 – Real Estate Settlements

Financial Crimes Enforcement Network

United States Department of the Treasury

Email: regcomments@FinCEN.treas.gov

Re: Notice of Proposed Rulemaking – Anti-Money Laundering Requirements for Persons Involved in Real Estate Closings and Settlements

Dear Sir or Madam:

I submit the following comments on the captioned proposed Advanced Notice of Proposed Rulemaking (the Advance Notice) on behalf of the REAL PROPERTY LAW SECTION OF THE STATE BAR OF GEORGIA, the section of the Mandatory State Bar of Georgia addressing real estate issues in the law and their more than 2000 members across the State of Georgia.

We endorse the comments submitted on behalf of the NATIONAL ASSOCIATION OF BAR-RELATED TITLE INSURERS (NABRTI) attached hereto as Exhibit "A".

In addition to the comments set forth in Exhibit "A" we wish to address the following issues set forth on page two of NABRTI's comments: Whether real estate attorneys should be deemed to be persons involved in real estate closings and settlement? And if so, should real estate attorneys be exempted from the Section 352 AML program requirement.

Real Estate Attorneys are persons involved in real estate closings and settlement. However, due to the role the real estate attorney serves at a closing, the importance of the attorney-client privilege and the fact that the due diligence required under the act would be more appropriately performed by the lenders and not duplicated by the closing attorney, which arguments are set forth in NABRTI's comments they should be exempt from any AML program requirements.

In addition to the arguments made in Exhibit "A", the practice of real estate, as it currently exists does not reasonably allow for the lawyer to be subject to AML requirements. Currently the practice of real estate is a fast moving process in which the

lawyer is often hired at the Eleventh hour. Unless the practice changes substantially, at great cost to the Purchaser and Seller, lawyers do not have sufficient time to make the required inquiries. While this section does not in any way discount the severity of our National state of security, exemption of attorney's from AML would not eliminate the AML requirements, but rather retain the requirements with the appropriate parties who are better equipped to serve the goals of the Department. Failure to exempt attorneys would only duplicate the process by parties who are not in a reasonable position to carry out these requirements.

Sincerely,

Rachel K. Iverson, Chair

STATE BAR OF GEORGIA

REAL PRPOERTY SECTION

EXHIBIT "A"

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Dear Sir or Madam:

We submit the following comments on the captioned proposed Advanced Notice of Proposed Rulemaking (the Advance Notice) on behalf of the National Association of Bar-Related™ Title Insurers (NABRTI), the national trade association of title insurance companies and their more than 20,000 attorney agents and law firms engaged in title insurance and settlement services across the country.

For the reasons set forth below, NABRTI submits that real estate attorneys should not be subject to any Anti-Money Laundering Program (AML) requirement, which in effect would require them to investigate their clients and violate their legal obligation to protect their clients' confidences. From a legal perspective, the failure to exempt real estate attorneys from the AML requirement would: (1) impose on real estate attorneys a duty to investigate their clients' intentions – which would convert real estate attorneys from client advocates to de facto government agents; and (2) conflict with long-standing rules of client confidentiality and attorney-client privilege. From a practical perspective, the implementation by real estate attorneys of any AML program (e.g., appointing a compliance officer, training employees and auditing the program) would: (1) duplicate the AML compliance efforts of banks and other traditional financial institutions; (2) delay the real estate closing process; and (3) result in significant compliance fees and expenses being passed on to the buyer or seller in a real estate transaction.

BACKGROUND

Section 352 of the USA PATRIOT Act requires every "financial institution" to establish an AML program which must include at least four things: (1) written policies, procedures, and controls; (2) a compliance officer; (3) an ongoing employee training program; and (4) an independent audit function to test the efficacy of the AML program.1 Section 352 also gives Treasury plenary discretion to "exempt from the application of [Section 352 AML] standards any financial institution that is not subject to the provisions of" 31 C.F.R. Part 103.2

NABRTI is responding to two of the four questions raised for comment by the Treasury and FinCEN, namely: (1) whether real estate attorneys should be deemed to be "persons involved in real estate closings and settlements"; and (2) whether real estate attorneys should be exempt from the Section 352 AML program requirement.

DISCUSSION

A. Client Confidentiality and the Attorney-Client Privilege Would Be Compromised If Real Estate Attorneys Were Required To Conduct AML Practices In Connection With Real Estate Closings

The oldest known privilege for confidential communications is the attorney-client privilege. 3 The purpose of the attorney-client privilege is to elicit "full and frank communication" between attorneys and their clients and thereby promote broader public interests by protecting the client's confidential communications from coerced disclosure.4

The attorney-client privilege and rules regarding client confidentiality have historically been left to the states in our Union to legislate and interpret. 5 Rules of professional conduct throughout the states address the fundamental nature of confidentiality and

attorney-client privilege. In many states, for example, the Rules of Professional Conduct regulating attorneys mirror the American Bar Association's Model Rules of Professional Conduct (the "Model Rules") and prohibit an attorney from revealing "information relating to the representation of a client unless the client consents."[6] The comments to the Bar Rules explain the basis for this rule:

> [a] fundamental principle in the client-lawyer relationship is that the lawyer maintain confidentiality of information relating to the representation. The client is thereby encouraged to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter.[7]

The basis for the rule is perfectly logical: a client will not approach an attorney for advice or representation if he or she suspects the attorney has an obligation to report him or her to law enforcement authorities (in a criminal setting, for instance) or divulge his or her confidences to an adverse party (in a commercial setting, for instance).

It is not surprising, then, that even the Securities and Exchange Commission (the "SEC") in its implementation this year of Section 307 of the Sarbanes Oxley Act ("SOXA") – which creates a new federal law exception to the otherwise strict attorney-client confidentiality standard – did not require outside counsel to audit, investigate or otherwise conduct due diligence on the intentions of their clients.[8] In establishing standards of professional conduct for attorneys who appear and practice before the SEC on behalf of public companies, an attorney must report "evidence" of a "material violation" of securities laws or "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 (or the equivalent thereof). 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. While this rule amplifies somewhat the traditional crime prevention exception to state bar rules regarding attorney-client confidentiality, it does not impose on the attorney a duty to investigate the bona fides of his client. The SEC believes that "because the rule does not require actual knowledge of the violation, there generally is no duty to investigate evidence of a material violation before reporting the potential violation."[9]

As Treasury and FinCEN are aware, any meaningful AML policies and procedures under Section 352 will require "persons engaged in real estate closings and settlements" to do some basic due diligence on the background and bona fides of the buyer of real property – tantamount to the "know-your-customer" or KYC procedures employed by depository institutions and other broker dealers today. Accordingly, if real estate attorneys were required to implement Section 352-type AML policies and procedures when dealing with a client, they could very well be identifying and verifying who their client is, asking questions about the source of the clients' funds, and checking client names on anti-terrorist databases such as the OFAC database. Further, real estate clients frequently are corporate clients, which could result in the additional burden of having to repeat the client identification and verification process for all the key decision-makers or controlling equity holders of a company.

While a lawyer should make adequate preparation including inquiry into relevant facts of his representation, and while the attorney should not accept as true that which he should not reasonably believe to be true, he does not have the responsibility to "audit" the affairs of his client or to assume, without reasonable cause, that a client's statement of the facts cannot be relied upon.[10] Therefore, the attorney need not question or disbelieve what his client tells him unless there is some tangible reason to do so. Indeed, to do otherwise would offend traditional understandings of attorney-client relations, insofar as it would undermine the parties' abilities to trust one another.[11] As the U.S. Court of Appeals for the Sixth Circuit has stated: "Although an attorney must not turn a blind eye to the obvious, an attorney should be able to give his clients the benefit of the doubt."[12]

Once client information is investigated and other KYC-type information is obtained, any meaningful AML policies and procedures will tell the holder of that information what to do when a yellow or red flag arises in the KYC process or other suspicious activity is detected. Sitting on the information produced in the course of the KYC process – without doing more – would emasculate the effectiveness of any AML program. Accordingly, the AML policies and procedures envisioned by Section 352 of the USA PATRIOT Act in effect would require "persons engaged in real estate closings and settlements" to report any suspicious information to law enforcement authorities that the customer or client might be a money launderer or terrorist financier. In the case of a bank, broker dealer, money service business or casino, for example, a suspicious activity report ("SAR") is filed when the facts and circumstances warrant such a filing. In the case of a real estate attorney, while the Advance Notice makes no mention of a SAR or similar filing requirement, it is not unreasonable to expect some type of suspicious activity reporting obligation to be built into a real estate attorney AML program. Such a reporting procedure, of course, would turn the attorney-client privilege on its head.

In this regard, the courts are loathe to turn attorneys into informants for the government. In United States v. Sindel, for example, the U.S. Court of Appeals for the Eighth Circuit held that the attorney-client privilege protects disclosures made by clients to attorneys, including client identity and fee information, where the disclosure would necessarily disclose confidential communications.[13] There, the IRS sought to enforce a summons requesting that the attorney provide identifying information regarding payors of cash payments of $10,000 or more as required on the IRS' suspicious transaction reporting form 8300.[14] The court held that the attorney could not release the information of a client where it would reveal the substance of confidential communications.[15] To require attorneys to report "suspicious" transactions would change the role of the attorney from advocate to government agent and impose on the attorney a duty to divulge which is not mandated by state or federal law or state bar rules of professional conduct.[16]

B. Imposition of an AML Program Requirement on Real Estate Attorneys would be duplicative of other AML practices, delay closings and dramatically increase the costs of real estate closings and will make home ownership less affordable.

From a practical perspective, the implementation of any AML program for real estate attorneys would: (1) be duplicative in light of other businesses (such as banks) implementing their AML practices in any given closing; (2) lead to substantial delays in the real estate closing process; and (3) result in significant compliance expenses being passed on to the buyer or seller of a real estate transaction.

Real estate attorneys and their law firms rarely, if ever, handle real estate closings by receiving hard currency from their clients or the other party to a transaction. Instead, 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 and obtained official or cashier's checks or instructed their bank or broker dealer to wire funds into the account designated by the counter-party. In this respect, other financial institutions who already are required under Section 352 to have AML programs in place perform basic KYC on the customer and, if appropriate, the source of funds. Because implementation of AML programs is already required of other financial institutions such as banks and broker dealers, the creation of a second line of AML defense by unnecessarily requiring real estate attorneys to adopt and implement an AML program is duplicative and serves no value-added role in our nation's war against money laundering and terrorism financing.

FinCen and Treasury have, in a similar advance notice of proposed rulemaking under Section 352, recognized an exemption for certain dealers in precious metals, stones or jewels because other "financial institutions" already are required to implement AML programs and, therefore, provide the necessary safeguard to mitigate money laundering risk.[17]

The proposal in the Advance Notice that real estate attorneys adopt Section 352-type AML programs would have the unforeseen consequence of converting common and relatively straightforward legal transactions – the purchase and sale of real estate – that are often closed in a matter of a few hours into a possibly protracted process in which both attorneys on each side of the transaction reaching a certain level of comfort that their own clients and the other party to a transaction is not using a closing as a means of laundering dirty money. This delay could result in additional hours being added to the process, if not days, until both real estate attorneys have investigated their client's identity and verified the source of the funds being used in the transaction.

In addition to the adoption of the written policies and procedures which have been discussed above, a Section 352-type AML program for real estate attorneys would also require the hiring or appointment of a compliance officer, the ongoing training of employees, and the auditing of the effectiveness of the AML program. To achieve compliance with these minimum requirements, real estate attorneys would be required to spend significant time and expense – much of which that would be passed on to their clients.

Real estate attorneys, like most attorneys in private practice in the United States, generally charge a fee for services rendered on the basis of the amount of time spent working on a real estate transaction. An AML program requirement that would require a real estate attorney to do some basic investigation on the identity of his or her client and then verify that identify, as well as the source of funds, would add to the time an attorney would take on a real estate transaction. This, of course, would result in an increase in the legal fee that a client would normally pay today for assistance with a closing. The increased legal fee would be particularly onerous for low- to moderate-income buyers or sellers of residential real estate.

Real estate attorneys, like most attorneys in private practice in the United States, generally pass through to their clients the costs incurred in working on a real estate transaction. A law firm with a real estate practice would need to hire a compliance officer knowledgeable in AML compliance generally. Alternatively, a law firm could appoint another attorney, but that attorney would need to spend substantial time becoming familiar with acceptable AML best practices and compliance. Moreover, the training of employees (especially for larger law firms) on an ongoing basis in AML compliance would add more expense. And appointing an internal or external auditor to test the efficacy of the law firm's AML program poses yet another significant expense. Most or all of these expenses – like other out-of-pocket costs and expenses incurred by a typical real estate attorney – likely would be passed on to the real estate attorney's client as part of the client's closing costs.

For the reasons set forth above, Treasury and FinCEN should reconsider their proposal of interpreting "persons involved in real estate closings and settlements" to include real estate attorneys. Real estate attorneys should be excluded from this definition or, alternatively, exempt from any AML program requirement.

NABRTI thanks the staff of Treasury and FinCEN for this opportunity to comment and appreciates the consideration of our views. Should there be any questions regarding our comments or regarding this letter, please feel free to contact Joanne P. Elliott, Executive Vice President of NABRTI.

Sincerely,

Joanne P. Elliott

Executive Vice President

1 See 31 U.S.C. § 5318(n)(1)(a).

2 31 U.S.C. § 5318(h)(2).

3 See United States v. Zolin, 491 U.S. 554, 562 (1989); Swidler & Berlin v. United States, 524 U.S. 399, 403 (1988); Neu v. Miami Herald Publishing Co., 462 So. 2d 821, 826 (1985); Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

4 See Swidler & Berlin, 524 U.S. at 403. See also Upjohn Co., 449 U.S. at 389 (stating that protecting confidential disclosures encourages full and frank communication between clients and their attorneys); Trammel v. United States, 445 U.S. 40, 51 (1980) (stating that attorney-client privilege rests on lawyer's need to know all relevant facts in order to provide effective legal advice); Fisher v. United States, 425 U.S. 391, 403 (1976) (stating that purpose of attorney-client privilege is to encourage full disclosure between clients and their attorneys); Hunt v. Blackburn, 128 U.S. 464, 470 (1888) (stating that effective legal assistance is not practically available unless client is free from apprehension of disclosure of his confidential communications to attorney).

5 See, e.g., Fed. Rule Evid. 501 advisory committee's note ("federal law should not supersede that of the States in substantive areas such as privilege absent a compelling reason. The Committee believes that in civil cases in the federal courts . . . there is no federal interest strong enough to justify departure from State policy.").

6 Fla. Rules of Prof'l Conduct, Rule 4-1.6 (2003).

7 Id. (emphasis added).

8 Securities and Exchange Commission, Implementation of Standards of Professional Conduct for Attorneys, Final Rule, 68 Fed. Reg. 6,296 (Jan. 29, 2003).

9 Fed. Reg. at 71,682 (emphasis added). See also Sean A. SeLegue, The New Frontier: Lawyers as Whistleblowers, presented in Practicing Law Institute, Patents, Copyrights, Trademarks and Literary Property Course Handbook Series, January – March 2003 (stating that "[t]he proposed [SEC] rule, however, is not intended to impose upon an attorney, whether employed or retained by the issuer, a duty to investigate evidence of a material violation or to determine whether in fact there is a material violation").

10 ABA Comm. on Ethics and Professional Responsibility, Formal Op. 335, at 92 (1974).

11 In Williams v. Whitmill, No. 84 C 4910, slip. op. (N.D. Ill. 1986), for example, the court held that counsel for a plaintiff prisoner in a habeas corpus proceeding did not have to "automatically suspect" their client when he gave them certain documents that later proved to be forgeries, even though the court previously had determined in another proceeding that the plaintiff had engaged in conduct that lacked veracity.

12 United States v. Wuliger, 981 F.2d 1497, 1505 (6th Cir. 1992).

13 United States v. Sindel, 53 F.3d 874 (8th Cir. 1995).

14 Id. at 875-76.

15 Id. at 876.

16 See also United States v. Gertner, 873 F. Supp. 729 (Mass. Dist. Ct. 1995) (holding that attorney-client privilege would be violated by requiring law firm to disclose identity of client from whom firm received cash payments exceeding $10,000).

17 See United States Department of the Treasury, Anti-Money Laundering Programs for Dealers in Precious Metals, Stones, or Jewels, Advance Notice of Proposed Rulemaking, 68 Fed. Reg. 8,480, 8,482 (Feb. 21, 2003) (“Therefore, there is substantially less risk that a retailer that purchases goods exclusively or almost exclusively from dealers [already] subject to the proposed rule will be abused by money launderers.”).