AMERICAN
LAND TITLE
ASSOCIATION

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P.O. Box 39
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ATTN: Section 352—Real Estate Settlements, 68 Fed. Reg. 17569 (April 10, 2003)

Dear Sir or Madam:

The Department of the Treasury published in the Federal Register an Advanced Notice of Proposed Rulemaking ("ANPR") seeking information to assist the Department in developing a rule to govern anti-money laundering compliance programs for "persons involved in real estate closings and settlements." *See* 68 Fed. Reg. 17569 (April 10, 2003). These comments are respectfully submitted on behalf of the American Land Title Association (ALTA), the national trade association of the land title industry, in response to the ANPR.[1]

ALTA believes that in enacting the USA Patriot Act, Congress did not examine the relative risks of money laundering through real estate transactions, or specifically consider the role of the real estate closer in any potential money laundering activity, but simply incorporated this function in adopting Bank Secrecy Act amendments. ALTA also believes that the money-laundering risks presented by real estate closings are relatively small, compared to other types of financial assets. In fact, ALTA is not aware of any information demonstrating that the real estate closing process is being used to any significant degree for money laundering. From the information provided by the Department of the Treasury in the ANPR, the primary risk of money laundering in connection with

[1] The American Land Title Association's membership is composed of 2,400 title insurance companies, their agents, independent abstracters and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in titles. Most of our members also perform real estate closings, and in fact perform the majority of real estate closings in the United States. These firms and individuals employ nearly 100,000 persons and operate in every county in the country.

real estate does not appear to result from the real estate closing process itself, but rather from the activities of corrupt participants in the real estate industry. This type of money laundering is also not likely to be detected by the real estate closer. Because of the limited evidence of money laundering in connection with the real estate closing process, ALTA suggests that imposing a significant compliance burden on real estate closers is not justified.

ALTA consequently believes that the Department should proceed very cautiously in developing a money laundering compliance program. If the Department persists in proceeding, we also hope that it considers a functional definition of real estate closings and settlements, and examines potential exemptions based on the relative risks of money laundering versus the potential administrative burden. We therefore suggest that the Department consider an exemption for residential mortgage loan refinances and similar transactions because of the low risk of money laundering in this subset of transactions. In addition, we hope that the Department is sympathetic to the practical problems that would exist in developing a compliance program for solo practioners and for persons settling few transactions.

I. Background.

Section 352 of the USA PATRIOT Act amended section 5318(h) of the Bank Secrecy Act to require financial institutions to establish anti-money laundering compliance programs.[2] The definition of "financial institution" includes "persons involved in real estate closings and settlements."[3]

The land title industry is comprised of title insurance underwriters, title insurance agents, attorneys, abstracters, and others who are involved in the process of transferring title to real estate. In the land title industry, the terms "real estate closing" and "real estate settlement" are used interchangeably. Both

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[2] Section 352 provides that anti money laundering compliance programs at a minimum must include:

(A) the development of internal policies, procedures, and controls;

(B) the designation of a compliance officer;

(C) an ongoing employee training program; and

(D) an independent audit function to test programs.

See 31 U.S.C. § 5318(h).

[3] *See* 31 U.S.C. § 5312(a)(2)(U).

terms refer to the process of executing legally binding documents transferring title to real estate. The manner of accomplishing a real estate closing varies, typically depending on the geographic locality where the real estate is located. In the eastern part of the United States, real estate is typically transferred by a process sometimes referred to as "table closing," during which the buyer and seller and their representatives meet face-to-face and exchange signed documents necessary to accomplish the transfer of title. In some states the table closing is conducted by a licensed attorney. In other states the table closing is conducted by a non-attorney, who may be the employee of a title insurance company or of a title agency. In the western part of the United States, a process called "escrow closing" predominates. In an escrow closing, the parties do not meet face-to-face, but instead submit written instructions and documents to an "escrow agent" or "escrow closer," who receives and processes the documents and ultimately transfers title pursuant to the instructions received from the parties. Again, escrow closers may be employees of a title insurance company or of a title agency, or may be affiliated with companies that are not title insurance underwriters or agents.

In these comments, ALTA will refer to the person or entity that actually conducts the real estate closing or settlement as the "closer." This will distinguish the closer from other classes of persons or entities who do not conduct the closing but are also involved in real estate closings and settlements in a more general sense, including mortgage lenders, mortgage brokers, attorneys, and real estate sales agents and brokers, and who may or may not come within the statutory definition of "persons involved in real estate closings and settlements." In enacting the USA PATRIOT Act, Congress did not consider specifically the role of the real estate closer in any potential money laundering activity. Instead, section 352 of the USA PATRIOT Act simply amended section 5318(h) of the Bank Secrecy Act to require financial institutions, which is defined to include "persons involved in real estate closings and settlements," to establish anti-money laundering compliance programs.

In its Advanced Notice of Proposed Rulemaking, Treasury asked for responses to the following questions:

> 1. What are the money-laundering risks in real estate closings and settlements?
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> 2. How should the term "persons involved in real estate closings and settlements" be defined?
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> 3. Should any persons involved in real estate closings and settlements be exempted from coverage under section 352?

> 4. How should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?

ALTA's comments address each of these questions in turn.

II. What are the money-laundering risks in real estate closings and settlements?

ALTA believes that the money-laundering risks presented by real estate closings are relatively small, compared to other types of financial assets. Money laundering occurs when money from illegal activity is moved through the financial system to make it appear that the funds came from legitimate sources. Money laundering usually involves three stages, known as placement, layering, and integration. Real estate closings generally do not foster placement or layering. To the extent that real estate closings are used for money laundering, this would appear to occur primarily at the integration stage, after the tainted funds have been placed into the traditional banking or financial system.

In the placement stage, cash or cash equivalents are placed into the financial system. The ANPR states that placement could occur "for example, in the real estate industry through the payment for real estate with a large cash down payment." ALTA believes that this example is not representative of real estate closings, and that real estate closings themselves do not generally foster placement. Real estate closers rarely receive currency at closing. The average real estate closing has a sufficiently high value that it would require a large amount of currency, typically tens of thousands of dollars or more, to complete the transaction. Even if the buyer is financing most of the purchase price through a mortgage loan, the amount of funds due directly from the buyer at closing is still sufficiently large that currency is typically not accepted at closing. Real estate closers do not have the facilities to safeguard large amounts of currency or cash equivalents. Closers do not maintain vaults, have contracts with armored cash transporting services, or have the security personnel necessary to safeguard large sums of cash. Closers presented with cash at closing would typically direct the party to deposit or exchange the cash at a bank or thrift institution and return with a bank check. Indeed, some title companies as a matter of business practice have directed their closers to refuse to accept any currency at closing, primarily because of their lack of facilities to handle and safeguard large sums of cash. Therefore, a money launderer seeking to place

tainted cash would have to place that cash through a bank or similar depository institution, rather than through a real estate closer.[4]

The examples of placement given in the ANPR do not involve real estate closings or closers, but instead involve other participants in the real estate industry operating outside the closing. One example given in the ANPR is of "the payment for real estate with a large cash down payment." In the case cited in the ANPR as an example of such placement, *United States v. High,* 117 F.3d 464 (11th Cir. 1997), a drug trafficker gave cash to a corrupt real estate sales agent, who converted the cash to five separate cashier's checks in order to make the down payment. 117 F.3d at 467. The cash itself was apparently not used for the down payment. Instead, it appears from the opinion in the case that the primary money laundering activity of the corrupt real estate sales agent was structuring, i.e. arranging for the purchase of cashier's checks, presumably from a bank or other depository institution, with cash in order to avoid the currency transaction reporting requirements in 31 U.S.C. § 5313(a). Once the cash had been "placed" and converted to cashier's checks, these checks were then used as a down payment for the purchase of real estate. (The drug trafficker also made cash payments directly to the seller in the real estate agent's office.) The illegal activity in *High* did not involve a real estate closing or closer.

In fact, in many transactions the real estate sales agent or broker representing the seller collects the down payment, rather than the closer. The real estate agent or broker then deposits the down payment in an escrow account maintained by the real estate broker. Therefore, to the extent that the Department is concerned by the potential for placement represented by its example, the definition of "persons involved in real estate closings and settlements" must include the person receiving the down payment, who often will not be the closer.

In another case cited in the ANPR, *United States v. Leslie,* 103 F.3d 1093 (2d Cir. 1997), the owner of a real estate business agreed to launder the proceeds of illegal drug trafficking by exchanging tainted cash for checks drawn on the account of his real estate company. Again, no real estate closer was involved in the illegal activity, nor does it appear that any real estate was to be purchased in connection with the money-laundering scheme. (The opinion does not indicate exactly how the owner of the real estate business intended to dispose of the tainted currency that he was to receive in exchange for the checks.) The type of money laundering activity exemplified by the *Leslie* case is much more likely to

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[4] In the rare instances when cash is received in a real estate closing, existing law already provides that receipt of cash amounts exceeding $10,000 would trigger a Form 8300 reporting obligation.

be detected by the bank or other depository institution receiving the tainted cash from the corrupt real estate investor rather than by any real estate closer. The *Leslie* case is further evidence that if the Department is concerned by the potential for placement represented by the factual situation in *Leslie*, its focus must extend beyond the real estate closer.

Layering describes the distancing of illegal proceeds from their criminal source through the creation of complex layers of financial transactions. The example of layering given in the ANPR is "when, for instance, multiple pieces of real estate are bought and resold, swapped, or syndicated, making it more difficult to trace the true origin of the funds."

In ALTA's view, real estate closings do not generally foster layering. Real estate transfers are recorded in the public land records of the jurisdiction where the land is located. These public land records are preserved for generations. Consequently, there is a permanent, publicly available, and indexed record of real estate transactions enabling law enforcement authorities (or indeed any person) to trace successive real estate transfers.

Secondly, real estate transactions generally take considerable time to complete, compared with transactions involving financial assets such as stocks, bonds, or other financial instruments. Thus any "layering" involving real estate closings would require a substantial period of time to accomplish. In addition, real estate transfers generally involve substantial transaction costs, including real estate transfer taxes, brokerage commissions, and costs related to closing. While these transaction costs by themselves may not deter a criminal money launderer, when combined with the other drawbacks identified above they reinforce the conclusion that real estate closings are not attractive vehicles for layering. Thus, while it is certainly possible for multiple parcels of real estate to be "bought and resold" or "swapped," these transactions will be time-consuming, will involve significant transaction costs and will be a matter of public record.

It is also important to recognize that likely avenues for "layering" involving real estate, such as the syndication example given in the ANPR, occur outside the closing process. It is true that legitimate real estate investors often form corporations or partnerships to act as investment vehicles for real estate purchases and sales. The closer typically will know the identity of the partnership or corporation making the purchase or sale, and will verify that the entity is validly formed and authorized to make the transaction. The closer, however, will typically have no information regarding the identity of the investors in the partnership or corporation. Often, legitimate real estate investors may have multiple corporations or partnerships acting as investment vehicles. To the extent that criminal money launderers mimic this legitimate pattern of real estate investment to disguise their sources of funds, the real estate closer will

not have access to information that will permit detection of this type of layering. Again, to the extent that the Department is concerned by the potential for layering represented by its example of syndication, or by a similar use of corporations or partnerships acting as real estate investment vehicles, the definition of "persons involved in real estate closings and settlements" and the anti-money laundering program must include persons other than the closer.

Integration occurs when illegal funds previously placed into the financial system are made to appear to have been derived from a legitimate source. The example of integration given in the ANPR 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 check that the money launderer has the ability to represent as the proceeds of a legitimate business transaction."[5]

Real estate is a well-recognized asset, and real estate itself or proceeds derived from the sale of real estate will certainly appear to be legitimate, as would proceeds from other types of traditional assets, such as stocks or bonds. Given the breadth of the concept of "integration" in money laundering, any well-recognized legitimate asset can be used for "integration." Therefore, it is undeniable that real estate can be used for integration, as can any other traditional asset. Once the criminal money launderer succeeds in completing the placement and layering stages of money laundering, there is relatively little that a closer can do to detect money laundering in real estate at the integration stage. The closer will know the identity of the seller of record, but beyond that fact a closer will not typically have access to information that would provide a reasonable basis for believing that a particular seller had previously purchased real property with the proceeds of criminal activity.[6]

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[5] In another case cited in the ANPR, *United States v. Nattier,* 127 F.3d 655 (8th Cir. 1997), one of the owners of a legitimate, pre-existing real estate investment corporation embezzled funds from a bank by having the bank issue checks payable to the real estate investment corporation. The checks were deposited in the account of the real estate investment corporation and the funds used to purchase real estate. No real estate closer was involved in the illegal activity, nor does it seem that any anti-money laundering program by a real estate closer could have detected that the source of funds used by the legitimate, pre-existing real estate investment corporation was tainted.

[6] Even in what might superficially appear to be a relatively straightforward situation, such as a seller who requests that sales proceeds be transmitted to a bank account in a foreign country designated as a "non-cooperative country" by the Financial Action Task Force, the real estate closer has no access to information permitting it to make any evaluation of whether the sales proceeds are tainted funds. Therefore, a closer could file voluntary SAR's with respect to all transactions involving an account in a non-cooperative country or no such transactions, but the closer has no basis for discriminating among such transactions to identify ones that are more likely to involve tainted funds

In sum, the real estate closing process itself does not appear to be a particularly attractive outlet for money laundering, and ALTA is not aware of any information demonstrating that the real estate closing process is being used to any significant degree for money laundering. Judging from the relatively few examples of money laundering given in the ANPR, the primary risk of money laundering in connection with real estate does not appear to result from the real estate closing process itself, but rather from the activities of corrupt participants in the real estate industry. This type of money laundering is not likely to be detected by the real estate closer. ALTA questions whether this limited evidence of money laundering in connection with the real estate closing process justifies imposing a significant compliance burden on real estate closers.

III. How should the term "persons involved in real estate closings and settlements" be defined?

As noted above, the real estate closer is generally not the person in the best position to detect the types of money laundering exemplified by the examples given in the ANPR. Therefore, to the extent that the Department wants to address the types of money laundering situations discussed in the ANPR, it will be necessary to include persons other than real estate closers in the definition of the term "persons involved in real estate closings and settlements." ALTA takes no position on whether persons other than real estate closers should also be included in the definition of "persons involved in real estate closings and settlements" as a general matter.[7]

The Department in its ANPR indicates its intention to include attorneys in the definition of the term "persons involved in real estate closings and settlements." ALTA recognizes that this can raise difficult issues of attorney-client privilege in certain situations. ALTA defers to attorney organizations such as the American Bar Association and its Gatekeeper Task Force, the National Association of Bar-Related Title Insurers, and the American College of Mortgage Attorneys, and the American College of Real Estate Lawyers to address these privilege issues involving attorneys.

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[7] ALTA notes, however, that in some instances employees of mortgage lenders or employees of real estate brokers conduct the real estate closing. In those instances in which employees of mortgage lenders or real estate brokers are actually conducting the real estate closing, as opposed to participating in the closing in their role as lender or broker, ALTA believes the definition of "persons involved in real estate closings and settlements" should clearly include such employees.

If the Department determines to define the term "persons involved in real estate closings and settlements" to include real estate closers, ALTA suggests the following functional definition of a real estate closer:

> any person who conducts the process of accepting, delivering, and recording legally binding documents transferring title to real estate or creating a mortgage lien secured by real estate.

It is important to note that this definition would apply to a title insurance company only when the company is conducting a closing through its own employees, i.e. through its branch offices or "direct operations," as the term is used in the industry. The definition would not apply to a title insurance company that was not performing the closing. The fact that a title insurance policy underwritten by the company was being issued to a participant in the transaction, that an issuing agent of the title insurer was involved in the closing, or that some other title-related product prepared by the title insurer, such as a title search report or insured closing letter, was being used in the transaction, would not make the title insurer a person involved in that closing. Responsibility for anti-money laundering compliance in connection with a particular real estate transaction should rest with the person or entity performing the closing. The fact that a title insurance policy or other title product is issued should not make a title insurer a person "involved in real estate closings and settlements."

IV. Should any persons involved in real estate closings and settlements be exempted from coverage under section 352?

Section 352 authorizes the Secretary to "exempt from the application of those [minimum] standards [for anti money laundering compliance programs] any financial institution that is not subject to the provisions of the rules contained in part 103 of title 31, of the Code of Federal regulations, or any successor rule thereto, for so long as such financial institution is not subject to the provisions of such rules." *See* 31 U.S.C. § 5318(h)(2).

ALTA proposes the following exemptions from the requirement to establish anti money laundering compliance programs for certain "persons involved in real estate closings and settlements."

A. Exemption for small proprietors and solo practitioners.

Many real estate closers are sole proprietorships or small businesses, and the requirements of section 352 must be applied in that context. Based on a

survey conducted by ALTA in 2002, which was a strong year for the real estate industry, 51 percent of the title insurance agents and abstractors in the country earned less than $500,000 in gross revenue in 2001, and 72 percent earned less than $1,000,000. Sixty-eight percent of title insurance agents and abstractors had 10 or fewer employees, and 42 percent had fewer than five employees. ALTA believes that the costs and burdens involved in carrying out a formal section 352 compliance program for these small closers outweigh the benefits from such a program. At the very least, the Department should recognize that the formal requirements of section 352 are awkward to apply in such small offices when only one or two real estate professionals act as closers, supported by two or three support staff, who may even be part time staff. For example, section 352 requires the designation of a compliance officer. When only one or two real estate professionals in a business act as closers, designating the "compliance officer" is technically possible, but pointless. Similarly, it is unclear how the requirement for an annual audit of the "compliance program" can be implemented in a way that is both meaningful and cost-effective for such small businesses. In many small-town settings, the only "auditor" with sufficient expertise to review a closer's compliance program is likely to be a competitor, and there will be an understandable reluctance to grant a competitor sufficient access to closing files to enable a meaningful audit to be conducted. In considering a proposed rule to implement section 352, the Department must focus on these issues relating to the impact of compliance program on small businesses.

Therefore, ALTA urges the Department to give serious consideration to an exemption for small closers. One approach would be to exempt closers that are sole proprietorships or have only a limited number of real estate professionals performing closings. This could be accomplished by modifying the definition of "persons involved in real estate closings and settlements" suggested in Part III above to add the following exception:

> except that, a person who conducts business as a sole proprietorship or as a business with three or fewer individuals performing real estate closings shall not be considered a person involved in real estate closings and settlements.

An alternative approach would be to exempt persons who conduct a limited number of real estate transactions each year. This could be accomplished by modifying the definition of "persons involved in real estate closings and settlements" suggested in Part III, above to add the following exception:

> except that, a person who performs fewer than 20 real estate closings per year shall not be considered a

person involved in real estate closings and settlements.

B. Exemption for residential mortgage loans refinances and similar transactions involving financial institutions.

The Department could also consider an exemption for certain types of transactions, for example, transactions involving residential mortgage loan refinances, home equity loans, home equity lines of credit, and reverse mortgages issued by financial institutions. This proposed exemption is based on the fact that persons who are refinancing or establishing home equity loans or lines of credit would have already been subject to the anti-money laundering compliance program of their lender, and that residential refinances and home equity loans do not appear to be a likely avenue for money laundering. In order for a criminal money launderer to benefit from a refinancing, he must already have succeeded in purchasing residential real estate and obtaining a mortgage. Given that, it appears unlikely that money launderers would find it beneficial to go to the trouble to refinance such mortgages. Similarly, most home equity loans and lines of credit are secured by property that is already subject to a first mortgage loan. Again, it appears unlikely that most home equity loans and lines of credit would be a likely avenue for money laundering. The same is true for reverse mortgages.

Therefore, ALTA suggests that the definition of "persons involved in real estate closings and settlements" suggested in Part III, above, be further modified to add the following exception:

> and, except that, a person who performs a real estate closing for a transaction involving a mortgage loan refinancing, a home equity loan, a home equity line of credit, or a reverse mortgage for residential real estate shall not be considered a person involved in real estate closings and settlements for purposes of such transaction.

V. How should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?

As the Department has recognized in connection with anti-money laundering programs for other types of financial institutions, an anti-money laundering program for real estate closers should not be a "one size fits all

requirement." *See* 68 Fed. Reg. 23,640 at 23,643 (May 5, 2003)(section 352 proposed rule for commodity trading advisors). Each real estate closer "should have the flexibility to tailor its program to fit its business, taking into account factors such as its size, location, activities, and risks or vulnerabilities to money laundering." The Department should be especially sensitive to the impact of such a program on small businesses.

This flexibility is also necessary in developing and applying any examples of "red flags" in real estate transactions. The ANPR refers to potential red flag situations in real estate transactions identified by the ALTA. These red flag situations were based on a list originally developed by the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), the Canadian equivalent of FinCEN, for use in Canada by real estate brokers and agents.[8] While these red flag situations may be useful as starting points for discussion, they do not necessarily represent the best indicators for use in an anti-money laundering program established by real estate closers. More work needs to be done to identify such indicators.

Any anti-money laundering program for real estate closers must also recognize that in many situations the real estate closer is not in the best position to detect money laundering activities. As noted above, there are other classes of persons who are involved in real estate closings and settlements in a more general sense, including mortgage lenders, mortgage brokers, notary publics, and real estate sales agents and brokers. ALTA notes that members of these other classes are more likely to be in a position to detect money laundering activities than a real estate closer would be. For example, the real estate closer is likely to have little if any direct contact with the buyer or seller. In escrow closing states, the closer receives written instructions from the buyer and seller, usually transmitted by the buyer and seller's representatives or intermediaries, such as the real estate sales agent. Any signatures necessary to close the transaction are likely to be obtained by a specialized signature service or notary who meets the seller or buyer at her home or office and then transmits the signed original documents to the closer. Therefore, the closer in an escrow state is likely to process documents transmitted by others without having any direct contact with either the buyer or the seller, and to rely on the verification of identities made by other real estate professionals. At most, the escrow closer may respond to ministerial questions by telephone from the buyer or the seller regarding the timing or status of the transaction, whether particular documents have been

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[8] See FINTRAC Guideline 2, Suspicious Transactions, Section 5.9 (March 23, 2003). The Canadian Proceeds of Crime (Money Laundering) and Terrorist Financing Act, S.C. 2000 c.17, became law on June 29, 2000. Implementing regulations are found at P.C. 2001-1500 (Aug. 28, 2001) and P.C. 2002-781 (May 9, 2002).

received, and so forth. The escrow closer has no opportunity to make any assessment of the buyer or the seller.

Even in a table closing state, the closer has little opportunity to make any assessment of the buyer or the seller. First, even in table closing states, closers are increasingly adopting techniques similar to those used in escrow closing states. For example, it is increasingly common for sellers not to attend the table closing, but instead to furnish a power of attorney executed in the presence of a notary public to their real estate sales agent or other representative with instructions to sign documents on the seller's behalf. In these situations, the table closer has no direct contact with the seller. Even when buyer and seller are present at the closing, the relevant documents have often been prepared by other parties to the transaction, such as the mortgage lender, so that the closer's contact with the buyer and the seller is limited to a relatively short and ministerial one.

ALTA appreciates the opportunity to file comments with the Department regarding the ANPR, and stands ready to assist the Department in any way that it can on this issue. If you have any questions, please feel free to contact me on (202) 296-3671, ext 214. I can also be reached on ann-vomeigen@alta.org.

Sincerely,

Ann vom Eigen

Legislative and Regulatory Counsel

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