35 Pothier

ESCROW INSTITUTE OF CALIFORNIA
P.O. Box 1069, Carlsbad, California 92018-1069
(760) 633-4342-Office; (760) 942-1048-Fax

June 9, 2003

VIA ELECTRONIC MAIL
regcomments@fincen.treas.gov

Financial Crimes Enforcement Network
U.S. Department of the Treasury
P.O. Box 39
Vienna, Virginia 22183-0039

Re: **Advance Notice of Proposed Rulemaking**
Section 352, USA Patriot Act
"**Financial Crimes Enforcement Network;**
Anti-Money Laundering Program Requirements
for "Persons Involved In Real Estate Closings
And Settlements"

Dear Sir/Madam:

The Escrow Institute of California ("EIC"), a nonprofit organization composed of escrow companies licensed by the California Department of Corporations submits the comments set forth herein regarding the solicitation of public comments by the Financial Crimes Enforcement Network ("FinCEN") on questions pertaining to the implementation of rules under Section 352 of the USA Patriot Act of 2001 (the "Act"). Most of the escrow companies licensed by the California DOC are small, women-owned[1] and some are minority-owned businesses.[2] In California, licensed escrow companies conduct settlements on real estate and business purchase and sale transactions.

---

[1] In 1997, in California, women owned 27.3% of the state's businesses and generated $121.2 billion in revenues. Of the state's women-owned businesses, the same year, 14.7% had employees. U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Census Bureau; U.S. Small Business Administration, Office of Advocacy, *2002 Small Business Profile: California*

[2] In 1997, in California, the Census data indicate that minority-owned businesses totaled 738,000 comprising 28.8% of California's businesses, of which 20.6% were employers. U.S. Department of Commerce, Census Bureau; U.S. Small Business Administration, Office of Advocacy, *2002 Small Business Profile: California*

EIC appreciates the opportunity to provide its comments to the questions posed by the U.S. Treasury in FinCEN's[3] Advance Notice of Proposed Rulemaking ("Advance Notice") published in the Federal Register on April 10, 2003, Vol. 68, No. 69[4] by the U.S. Department of the Treasury regarding the requirement under Section 352 of the Act[5] that "financial institutions", including persons involved in real estate settlements and closings, establish anti-money laundering programs.[6]

I. INTRODUCTION.

EIC appreciates FinCEN's approach in soliciting public comments to questions it posed regarding money laundering problems as they may involve real estate settlements and closings before implementing rules that will affect thousands of businesses and may increase the cost of closings to consumers. In this way, EIC and others may inform FinCEN regarding the impact any rules it implements will have on the businesses and consumers who use their services.

/////

[3] Generally, FinCEN has three responsibilities. They are (a) to make available and analyze information to support financial crimes investigations, (b) to ensure financial institutions adopt programs to deter and detect money laundering and (c) to administer the Bank Secrecy Act to assure financial institutions implement and monitor internal programs to deter and detect money-laundering activities. In its undertaking, FinCEN provides policy recommendations and staff support to financial institutions for international anti-money laundering programs.

[4] On April 10, 2003, the Federal Register published in Vol. 68, No. 69, the Advance Notice of Proposed Rulemaking for the Department of the Treasury and FinCEN as No. 31 CFR Part 103.

[5] The Uniting and Strengthening America By Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 [Public Law 107-56] Title III of the Act is also referred to as the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. Title III made changes to the Bank Secrecy Act ("BSA") set forth at Subchapter II of Chapter 53 of Title 31, United States Code.

[6] As set forth in the Advance Notice of Proposed Rulemaking, the term "financial institution" has been defined in the federal Bank Secrecy Act ("BSA"), [subchapter II of Chapter 53 of Title 31, United States Code], to include persons involved in real estate settlements and closings [Section 5312(a)(1)(U)].

/////

II. ISSUES FOR COMMENT.

1. *What Are The Money Laundering Risks In Real Estate Closings and Settlements?*

FinCEN notes in the Advance Notice that the real estate industry "could be vulnerable" to money laundering at all stages of the money laundering process where there are involved "high value products" It references a report by the National Institute of Justice[7] which opined on the potential for real estate transactions to be used to launder illegal funds into legitimate courses.

FinCEN set forth three examples of narcotics traffickers' involvement in real estate all decided in 1997 including, (a) the purchase of real estate in a Georgia case using structured amounts of money in which the amounts deposited were below the Bank Secrecy Act reporting threshold, but in the aggregate exceeded the reporting threshold[8], (b) the laundering of cash in a New York case by exchanging cash for checks from a real estate company[9], and (c) the purchase, sale, exchange or syndication of several pieces of real estate in a Missouri case.[10]

---

[7] The National Institute of Justice sets forth on its Internet Web site at http://www.ojp.usdoj.gov/nij/about.htm that it is "the research, development, and evaluation agency of the U.S. Department of Justice and is solely dedicated to researching crime control and justice issues. NIJ provides objective, independent, evidence-based knowledge and tools to meet the challenges of crime and justice, particularly at the State and local levels. NIJ's principal authorities are derived from the Omnibus Crime Control and Safe Streets Act of 1968, as amended (see 42 USC * 3721-3723). " its mission is to "Advance scientific research, development, and evaluation to enhance the administration of justice and public safety."

[8] *U.S. vs. High*, 227 F. 3d 404 (11th Cir. 1997) tried in Georgia.

[9] *U.S. vs. Leslie*, 103 F.3d 1093 (2nd Cir. 1997) tried in New York.

[10] *U.S. vs. Nattier*, 127 F.3d 655 (8th Cir. 1997).

In its explanation of the levels at which money laundering can occur, FinCEN sets forth three stages including, (a) the placement stage[11], (b) the layering stage[12] and (c) the integration phase.[13] It further acknowledges the work completed by the American Land Title Association ("ALTA") in its effort to identify "red flag" situations where real estate may be the subject of laundering illicit funds through real estate transactions.[14]

While EIC supports effective rules to fight against potential money laundering activity in the real estate settlement and closing industries, it urges FinCEN to assure there is a reasonable high threat of using illiquid real estate before instituting new rules that will affect thousands of companies in the real estate settlement and closing industries and will add to the cost of closings. Presently, the real estate settlement

---

[11] FinCEN states this as the initial stage where the funds derived from illegal activities are first introduced into the financial system. In the case of real estate, FinCEN states it "could occur…through the payment for real estate with a large cash down payment."

[12] FinCEN states this as the second stage where the illicit funds are "disguised and distanced from the illegal source through the use of a series of frequently complex financial transactions." FinCEN states it "could occur…when…multiple pieces of real estate are bought and resold, exchanged, swapped, or syndicated, making it more difficult to trace the true origin of the funds."

[13] FinCEN states this as the third stage or phase where the funds from illegal sources now appear to be derived from legitimate sources. FinCEN states it "could occur…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 then has the ability to represent as the proceeds from a legitimate business transaction."

[14] The ALTA identified situations as "red flags" where (a) a buyer is paying for real estate with funds from a high country designated by the Financial Action Task Force ("FATF") or as a "primary money laundering concern", (b) the seller asks that the real estate sale proceeds be sent to a high risk country, (c) a person seeks to buy real estate in the name of a nominee without apparent legitimate explanation for the use of a nominee, (d) a person is acting, or appears to be acting, as an agent for an undisclosed party and is reluctant or unwilling to provide information about the undisclosed party or the reason for the agency, (e) a person does not appear to have adequate knowledge about the purpose or use of the real estate being purchased, (f) a person appears to be buying and selling the same real estate within a short period of time or is buying a number of pieces of real estate for no apparent legitimate purpose, (g) the buyer or seller wants to have the real estate documents reflect something other than the true nature of the transaction, and (h) a person provides suspicious documentation to verify the person's identity.

and closing industries are facing an effort by the U.S. Department of Housing and Urban Development to force settlement agents to lower their fees.[15]

Overall, the members of the EIC have not experienced real estate as a vehicle for money laundering activities and question whether rules beyond those presently in place will achieve a higher level of detection and prevention than the rules presently in place.[16] EIC avers the need for EIC to implement rules that will be new and act to reasonably achieve a greater result than the rules already in place.

Regarding international money laundering activities, the general experience of the EIC membership is that real estate, being by nature an illiquid commodity, is not the kind of vehicle that money launderers generally use. Furthermore, in the experience of the EIC membership, there are no known transactions where terrorists laundered money through real estate transactions.

EIC points out that rules to protect against possible money-laundering risks may not be cost-effective given the limited information or prevention which may be realized. Rules which are based solely on the ability of an illicit actor to launder money would be a hardship to small and minority-owned businesses and would have the potential for changing the way local real estate closings are processed throughout the United States thereby interfering with the orderly processing of settlement services without a reasonable certain benefit for FinCEN in its efforts to implement programs to detect and deter money-laundering activities.

---

[15] Proposed Rule on Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages To Reduce Settlement Costs to Consumers; Docket No. FR-4727-P-01; 67 Fed. Reg. 49134 (July 19, 2002); Comment Period Closed: October 28, 2002 and HUD is assessing the responses from interested parties.

[16] Settlement agents, including escrow companies, must report all cash transactions over $10,000 to the Internal Revenue Service ("IRS") on Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business.* The IRS conducts random audits to verify the cash reporting forms are being timely submitted. It is also looking for the receipt by closing agents of monetary instruments, including, but not limited to, cashier's checks, money orders and the like.

Therefore, EIC believes that the necessity for imposing new and additional rules on the real estate settlement and closing industries merits further careful review by FinCEN to assure it is not imposing rules on an industry already burdened by state and federal rules, all of which in one form or another are passed on to consumers.

2. ***How Should Persons Involved In Real Estate Closings and Settlement Be Defined?***

EIC recognizes the definition of a “financial institution" under the Bank Secrecy Act includes persons involved in real estate closings or settlements. However, given there is no definition of the term, EIC believes the definition for purposes of implementation of rules under Section 352 of the Act should be limited to include only those transactions in which there is posed a reasonable threat.

EIC believes that an definition of “persons involved in real estate closings and settlements” be limited to those situations where the services rendered or real estate interest acquired/disposed of are reasonably expected to be substantially abused by money launderers. In the usual residential or commercial transaction, the closing agent is not in a position to identify either the purpose or nature of the transaction or the source of funds deposited with them. Furthermore, what the parties do with the funds they receive from the real estate closing usually is unknown to the closing agent. In some cases, closing agents are aware of the use of the sale proceeds where, for example, sellers purchase other real estate or businesses and the closing agents know about it.

Further, except in the most general sense, the members of EIC are not positioned to know the intention of the parties. While they know the type of real estate involved, i.e., commercial, residential, vacant land and the like, they are not positioned to know the parties’ intentions regarding the use of the property after the closing except as may be set forth in the instructions to the closing agents.

Further, non-attorney closing agents do not structure or arrange transactions. This is especially true in commercial transactions where

the parties are commonly represented by attorneys and real estate professionals who draft the purchase and sale agreements along with the instructions to the escrow. In these regards, the closing agents follow the instructions of the parties and coordinate with their attorneys to effect a closing, however, their role is limited by the provisions of the escrow instructions. Thus, the source of funds of the parties, which they deposit into escrow, is not usually known. There may be some exceptions, but it is generally the rule that the funds come into escrow from resources known to the parties and, perhaps, their real estate agents/brokers and attorneys, but not known to the closing agent except as may be revealed on the instruments themselves.[17]

Thus, while closing agents are important to the settlement transaction, it does not automatically follow they are "well positioned to identify suspicious conduct". Indeed, most escrow transactions do not include deposits of cash. However, in those cases where cash is deposited, there are already in place regulations requiring closing agents to report suspicious activity involving cash transactions.

All real estate closings include a summary of the deposits and disbursements that occurred as part of the transaction. In California, the summary is contained in a HUD-1, Settlement Statement or a Closing Statement depending upon the type of transaction. Thus, in one-to-four family dwelling transactions, a form prescribed by the federal Real Estate Settlement Procedures Act.[18] Where lenders are involved, they along with the buyers and sellers receive copies of the HUD-1, Settlement Statement or the Closing Statement after the closing.

EIC believes that persons not involved in the structuring of the real estate transaction should not be included in the definition of persons "involved in real estate closings and settlements" for purposes of implementing Section 352 of the Act. As an industry, as non-attorneys

[17] For example, if a check is deposited into the escrow, it sets forth the name and address of the bank along with the account number. Where the parties get the money they deposit is usually unknown to the closing agent.

[18] 12 USC Section 2603.

and non-real estate brokers, they do not negotiate the transactions and do not know who the "behind-the-scenes" players may be. For these reasons alone, they are not well positioned to identify suspicious and prevent money-laundering conduct.

FinCEN should also consider using a definition to exempt small businesses that is reflective of the average deposits it maintains in its trust accounts. For example, a company that handles smaller residential real estate transactions may have the same number or more employees than another company, but smaller trust account balances because it handles lower priced real estate transactions.

The California Escrow Agents' Fidelity Corporation[19] maintains statistics on the trust account balances maintained by escrow companies licensed by the California Department of Corporations. In its March 2003 statistics, it found that 98.6% of the escrow companies had average balances below $9,999,999, 95% had balances less than $5 million, 88% had balances below $3 million, 77% had balances below $2 million and 58% had balances below $999,999. Therefore, EIC points out that the small businesses comprising most of the escrow companies licensed by the Department of Corporations do not handle transactions that would be attractive to money-launderers.

3. ***Should Any Persons Involved in Real Estate Closings or Settlements Be Exempted From Coverage Under Section 352?***

EIC believes that residential transactions and small commercial/vacant land transactions have not been revealed as likely targets or vehicles for money-laundering activities. While very large commercial real estate projects involving millions of dollars may be targets because of

---

[19] The Escrow Agents' Fidelity Corporation ("EAFC") is a non-profit mutual benefit corporation with a membership consisting of escrow companies licensed by the California Department of Corporations. EAFC members are those licensees engaged in the business of receiving escrows set forth in California Financial Code §17312(c). The EAFC indemnifies member escrow companies against loss of trust obligations caused by employee embezzlement, subject to the limitations set forth in the California Financial Code. The EAFC has approximately 550 members with 720 offices, including branch offices.

the amount of money FinCEN believes may be filtered through real estate purchases and sales, EIC does not believe the smaller transactions lend themselves to the efficiency money-launderers may be looking for in moving illicit money into and out of real estate.

Settlement agents are already subject to reporting requirements on cash transactions as set forth above. Thus, 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.

EIC observes that FinCEN in taking the position in its Advance Notice that it does not intend to "cover purchasers and sellers of their own real estate" ignores important players in the money-laundering schemes. If, for example, sellers were laundering funds, would FinCEN not want to know that from the parties themselves? Why would FinCEN ignore this important source of information and, instead, move the responsibility for detecting and deterring to closing agents and others?

For the reasons set forth in this letter, EIC respectfully suggests that licensed closing agents who are not involved in structuring transactions and who are acting only as the closing agent be exempt from any proposed or final rule since they are not in a reasonable position to detect and deter money-laundering activities. Further, EIC respectfully requests that certain types of transactions, including residential and small commercial real estate transactions under, say, $5 million, because they are not high-risk vehicles for money laundering, be specifically excluded from any proposed or final rule.

4. ***How Should the Anti-Money Laundering Program Requirement for Persons Involved in Real Estate Closings and Settlements Be Structured?***

In considering how to apply Section 352 of the Act, FinCEN acknowledges it shall consider the extent to which the standards for anti-money laundering programs are appropriate with the size, location and activities of persons in the real estate closing industry.

> EIC believes that FinCEN has not defined residential and smaller commercial/investment real estate as vehicles of money-laundering activities. Thus, to impose the onerous requirements of maintaining mandatory suspicious activity reporting programs on closing agents will increase the costs to consumers with a questionable resulting benefit to FinCEN's goals.
>
> Additionally, licensed closing agents under the scrutiny of state agencies and who are subject to annual audits by Certified Public Accountants should likewise be exempt. For example, in California, the Department of Corporations licenses escrow companies who perform real estate closings.[20] As part of the regulatory system, escrow companies are audited by the Department of Corporations who examines the financial transactions into and out of the trust accounts maintained, generally, at commercial banks or other statutorily approved financial institutions. Licensed escrow companies must undergo annual audits by Certified Public Accountants who must comply with generally accepted accounting principles as well as the particular requirements of the Department of Corporations in rendering their audit reports. The commercial banks question cash transactions, being alert to them because of their own requirements for reporting cash transactions. Additionally, the Certified Public Accountants look at the nature of the deposits and disbursements from trust accounts being interested to know if the required IRS Form 8300 is filed on affected cash transactions.
>
> Finally, title companies are commonly involved in real estate closings in California and are informed of the "red flags" denoted by the ALTA as signals where actors may try to use real estate to launder illicit funds.

In summary, the EIC supports FinCEN in its efforts to strengthen the anti-money laundering system and rules already in effect. However, on residential and smaller commercial real estate transactions, it does not believe those situations present high-risk vehicles for money laundering and should be

[20] California Financial Code §§10000, et seq. and implementing rules of the Commissioner of Corporations.

specifically excluded from any proposed or final rule. Furthermore, imposing rules on small business closing agents requiring them to implement a compliance program including the appointment of a compliance officer, will increase the overall costs to the consumers on real estate closings. The latter is in consideration of the current efforts by HUD to curtail the income of closing agents under its pending action.

Thank you for considering the comments of EIC in its investigation of factors affecting real estate closings and the persons who perform the service. If you have any questions or need additional information, please contact us accordingly.

Sincerely,

Rose Pothier
Counsel for
Escrow Institute of California

cc: Escrow Institute of California