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Will the Patriot Act next effect the real estate industry?

By Matthew Henshon

U.S. TREASURY OFFICIALS HAVE CAST AN EYE TO BROADEN WHAT CONSTITUTES A 'FINANCIAL INSTITUTION'

If you have been paying attention to the Democratic Presidential campaign this winter, you have undoubtedly heard about the USA Patriot Act. The Democrats have claimed that it is not only too intrusive, but that some of its lesser-known provisions may be prone to abuse.

And though the candidates are generally talking about the criminal portions of the Act, a somewhat-obscure provision may effect you if you are a real-estate professional involved in "real estate closings and settlements." There is a good chance that the real estate industry will be subject to certain of the Patriot Act's provisions as soon as this spring.

How did quintessentially local transactions, such as real estate closings, become of interest to federal authorities? In the aftermath of September 11th, investigators determined that the terrorists had used common financial vehicles – ATMs and credit cards – to "launder" money that was used as part of the attacks. To increase the reporting requirements surrounding significant monetary transfers, Congress passed the Patriot Act, which was signed into law on October 26, 2001. The Act authorized the Treasury Department to ensure that all "financial institutions" comply with the following anti-money laundering (AML) requirements:

- the development of internal policies, procedures, and c ontrols;
- designation of a compliance officer;
- an on-going training program for employees; and
- an independent audit function to test programs.

These requirements were intended to capture information helpful to federal investigators in determining whether particular transactions involve laundering, thus aiding the prevention of terrorism and other criminal activity.

Almost immediately, the Patriot Act was applied to traditional financial entities, like banks, which were required to have these AML programs in place within six months after the Act's passage.

Already subject to (less-intrusive) reporting requirements under the Bank Secrecy Act and other laws, these requirements were merely one more burden on an already heavily regulated industry. The AML rules have also been applied to other traditional financial institutions such as securities brokers. But again, as many of these institutions already have a layer of federal regulation, compliance with the Patriot Act provisions was not viewed as an overwhelming burden, nor did it require a significant shift in business practices.

Treasury officials have now begun to focus on a much broader range of "financial institutions" (as defined in the Act) -- including those "involved in real estate closings and settlements" -- that were not addressed earlier.

Last April, the Treasury Department released for comment "advance" notice of proposed regulations that indicated that Treasury is considering extending the four AML requirements to a broad section of the real estate industry -- brokers, title insurers, escrow agents, appraisers, mortgage brokers, and even attorneys -- all of whom could help the federal government determine the legitimacy of funds, and provide certain information about the parties if money laundering were suspected.

The Treasury sought input on the risks of money laundering in the real estate industry, and the effect the AML requirements could have if imposed on

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the various players.Several industry groups weighed in on the direction of the proposed regulations during the open comment period last summer, raising the following issues (among others):

- **The costs of record-keeping.** Because many of the real estate players – law firms, brokerages, mortgage-brokers, and appraisers – are small- to medium-sized businesses, there are concerns that they will not have the resources to handle the potentially increased regulatory burden.

- **The nature of real estate transactions.** The very nature of many real estate transactions, with single-member LLCs, nominee trusts, and other shielding devices, may raise concerns where none are warranted. A buyer of property may have legitimate, strategic reasons to remain anonymous -- think of a buyer trying to accumulate contiguous parcels for a large development, where the owner of the last "puzzle piece" may have enormous power. Thus, time and resources will be spent facilitating the government's review of common transactions, potentially causing costly delays.

- **Special concerns for attorneys.** Issues of privilege present an additional problem for attorneys involved in the real estate closing process. The majority of the AML requirements involve the possible sharing of client information with the federal government. The attorney-client relationship must be respected by any regulations that are ultimately adopted.

Although the broad application of AML reporting requirements may not be extended to every player in the real estate industry, some degree of federal regulation of the real estate industry seems likely to be promulgated later this spring. The terrorist attacks of September 11th changed much about how Americans view the world. And the Patriot Act will almost certainly change the nature of real estate transactions, as well.

About Matt Henshon :

Matt Henshon founded the Allerton Law Group in 2000, a Boston-based boutique law firm specializing in business and commercial real estate transactions. Prior to forming Allerton, Matt served as Senator Bill Bradley's "traveling chief-of-staff" during the 2000 Presidential campaign. He is a graduate of Princeton University and Harvard Law School.