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■ REAL ESTATE ■

Deeds...and terrorism?

By Kevin L. Shepherd special to the national law journal

THE TREASURY Department has taken steps to fashion regulations that will govern the extent to which anti-money laundering and anti-terrorism financing requirements will be imposed on the commercial real estate industry. This action, primarily driven by the USA Patriot Act, may have profound and potentially unintended implications for the commercial real estate industry, including real estate lawyers. Treasury has identified several issues it considers germane to developing the regulations. Foremost among these is the issue of how persons involved in real estate closings and settlements should be defined. Comments are due to Treasury by June 9.

At issue is how Treasury should define the phrase "persons involved in real estate closings and settlements." This phrase is one category of "financial institutions" under the Bank Secrecy Act. The USA Patriot Act, a congressional product of the Sept. 11, 2001, terrorist attacks, amended the secrecy act to require that every financial institution establish an anti-money laundering program that includes, as minimal elements, the development of internal policies and controls, the designation of a compliance officer, an ongoing employee training program and an independent audit function to test programs.

Treasury needs to exercise considerable caution and restraint in developing regulations that will affect a multitrillion-dollar industry that is critical to the American economy. Commercial real estate closings and settlements are not homogeneous; they range enormously in complexity and in the number and sophistication of participants. Participants may include the buyer and seller, lender, settlement officer, escrow agent, title insurance company, brokers and real estate lawyers.

Imposing a federal regulatory regime on commercial real estate closings and settlements, however well-intentioned, may have unintended consequences and lead to market disruption, increased costs and reduced efficiency, all without a corresponding benefit of detecting and preventing money laundering and terrorist financing. Indeed, Treasury has not been persuasive in showing that a money laundering problem exists in the commercial real estate industry.

Preserving market efficiencies is vital. This can partly be accomplished by placing the burden of compliance on the parties best able to afford it, such as commercial lenders. Other participants should be able to rely on that due diligence for as long as it is reasonable to do so. Duplication of effort will consume scarce resources. Particular emphasis should be placed on participants who act as financial intermediaries. If a party is touching the money, it should be responsible for complying with the anti-laundering requirements. Any regulatory regime needs clarity and certainty. The creation of a checklist or a series of red flags may inject clarity and certainty into the regulatory regime. For example, a key consideration is the scope of the regulations. The words "closings" and "settlements" have an accepted meaning within the industry. But the proposed rulemaking alludes to other types of real estate transactions as well.

Lawyers are not immune from the scope of this regulatory effort. Lawyers often structure transactions, the complexity of which could mask money laundering activities. But clients, and not the lawyers, are usually better positioned to undertake due diligence, much in the same way clients perform other real estate due diligence activity. Lawyers should have the primary responsibility of counseling their clients to comply with anti-laundering rules. If clients are unable to perform the due diligence, they should ensure that other participants involved in the real estate closing and settlement process have undertaken it.

Treasury should carefully consider the attorney-client privilege and client-confidentiality issues involved if it imposes anti-laundering requirements on lawyers. For example, the requirement that an independent auditor be engaged to verify whether the attorney's anti-money laundering program is sufficient may run afoul of these core principles if the auditor has free access to a client's files and records. Similar concerns exist regarding the scope and nature of the due diligence compliance activities an attorney may be required to perform.

The Sept. 11, 2001, terrorist attacks may take yet another toll on the American economy if Treasury imposes onerous and impractical requirements on the commercial real estate industry. Treasury should continue its dialogue with interested industry participants to ensure that any regulatory regime is sensible and does not force lawyers to breach ethical obligations to comply with a federalized real estate regulatory regime. NLJ

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