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**Would You Believe...  
OFAC and Money Laundering  
Regulations Bump into  
Real Estate**

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**Would You Believe...**  
**OFAC and Money Laundering Regulations**  
**Bump into Real estate Transactions**

Prepared by Keenan Kolendo and Ann Saegert

**I. Introduction**

In response to terrorist attacks on the United States on September 11, 2001, the Federal Government enacted new laws and amended existing laws designed to prevent terrorism, creating two separate compliance regimes. The first is based upon the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept Terrorism Act (often referred to as the USA PATRIOT Act, and herein referred to as the "Act"), which imposes prohibitions on certain kinds of financial transactions and imposes new detection responsibilities for companies and individuals involved in financial transactions. The second is based upon Executive Order 13224 (the "Executive Order"), which prohibits nearly all business dealings with thousands of individuals and entities named in the Executive Order and on the list of "Specially Designated Nationals & Blocked Persons" (the "OFAC List"), which is maintained and updated by the Department of the Treasury and the Department of State and published by the Office of Foreign Assets Control. The purpose of this paper is to outline: (i) the background of the Act and the Executive Order; (ii) the scope, prohibitions, requirements and penalties of the Act and the Executive Order, as they are applicable to the real estate industry, including lawyers; and (iii) the practical, policy and legal issues related to the application of the Act and the Executive Order to the real estate industry, including lawyers.

**II. Background**

A. International Background – The Gatekeeper Initiative:

Attempts to fight terrorism by trying to eliminate the financial transactions that enable it predate September 11, 2001. In 1989, the G-7 Summit in Paris established the Task Force on Money Laundering (the "FATF"). The mission of this inter-governmental body is to fight money-laundering activities on an international basis. It has no "legal" standing as such, and its pronouncements are not "binding," but countries are designated as either "cooperative" or "noncooperative," relative to compliance with its recommendations.<sup>1</sup>

The FATF developed the "Forty Recommendations" for governments and private sector entities,<sup>2</sup> an adjunct of which is the so-called "Gatekeeper Initiative," gatekeepers being those "professionals, including lawyers, accountants, and auditors, who are involved in assisting clients with domestic and international financial transactions and business dealings."<sup>3</sup> For example, one of the recommendations is that "lawyers...should report suspicious transactions when they engage on behalf of a client...buying or selling real estate securities...the operation of companies...or the buying or selling of business entities." The ABA Task Force on Gatekeeper

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<sup>1</sup> The FATF website is at <http://www.fatf-gafi.org/>. As of July, 2004, the following countries are listed by FATF as "noncooperative" – Cook Islands, Indonesia, Myanmar, Nauru, Nigeria and Philippines. It is also noteworthy that the International Monetary Fund monitors intentional compliance with anti-money laundering standards and uses the recommendations of FATF in its activities. Further, the World Bank also collaborates with FATF in connection with anti-money laundering activities. Additionally, following September 11, the FATF issued "Special Recommendations on Terrorist Financing" to be implemented by nations around the world.

<sup>2</sup> Available at [http://www.fatf-gafi.org/pdf/40Recs-2003\\_en.pdf](http://www.fatf-gafi.org/pdf/40Recs-2003_en.pdf).

<sup>3</sup> See ABA Task Force on Gatekeeper Regulation and the Profession – Comments of the ABA Task Force on Gatekeeper Regulation and the Profession on the Financial Action Task Force Consultation Paper dated May 30, 2002 (available at <http://www.abanet.org/crimjust/taskforce/comments.doc>).

Regulation and the Profession notes that many of the Forty Recommendations may be applicable to lawyers.<sup>4</sup>

The September/October 2002 edition of *Probate & Property* (the magazine of the ABA Real Property Probate & Trust Section), published an article authored by Kevin Shepherd entitled "The USA Patriot Act and the Gatekeeper Initiative – Surprising Implications for Transactional Lawyers".<sup>5</sup> That article reviews some of the early work of FATF and the development of the Gatekeeper Initiative and describes the implementation of the Gatekeeper Initiative in other countries. Mr. Shepherd's description of the various approaches follows:

- UK Approach. Lawyers are subjected to suspicious activity reporting (SAR) requirements and internal compliance requirements. Under the UK approach, there is an exception for certain litigation matters. The UK approach makes it a criminal offense for a lawyer to alert a client that the lawyer is filing an SAR with the governmental authorities.
- EU Directive Approach. Under the European Union Directive approach, lawyers are subjected to the SAR requirement with a litigation exception and an exception for 'ascertaining the legal position' of a client.
- Switzerland/Channel Islands Approach. Under the approach adopted by Switzerland and the Channel Islands (i.e., Jersey, Guernsey, Gibraltar, and the Isle of Man), lawyers are subject to registration with a regulatory body, licensing, anti-money laundering compliance programs, record-keeping, and SAR requirements.

It would appear then that in many countries "Gatekeepers" are now operating under the same or similar anti-money laundering laws and regulations as financial institutions. It remains to be seen exactly how far these types of regulations will be implemented in the United States.<sup>6</sup>

## B. Domestic Background

Title III of the Act (known as the International Money Laundering and Abatement and Financial Anti-Terrorism Act of 2001<sup>7</sup>), amended the Bank Secrecy Act of 1970 (the "BSA").<sup>8</sup> The BSA operates as a disclosure law and was enacted by Congress primarily in response to congressional concern that foreign banks were laundering the proceeds of illegal activity and evading federal income taxes.<sup>9</sup> When enacted, the BSA applied to traditional financial institutions, such as insured banks,<sup>10</sup> but over the years the BSA has been expanded and new crimes have been

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<sup>4</sup> *Id.*

<sup>5</sup> Available at <http://www.abanet.org/rpmt/publications/magazine/2002/so/shepherd.html>.

<sup>6</sup> It should also be noted, however, that the Gatekeeper Initiative is controlled by the Department of Justice, while the compliance programs under §352 of the USA PATRIOT Act, described in more detail below, are under the ambit of the Department of Treasury.

<sup>7</sup> 31 U.S.C. §§ 5311-5355.

<sup>8</sup> Pub. L. No. 91-508, 84 Stat. 1305 (1970), as amended, codified at 12 U.S.C. §1829b, 12 U.S.C. §§ 1951-1959, and 31 U.S.C. §§5311-5332.

<sup>9</sup> See John K. Villa, "A Critical View of Bank Secrecy Act Enforcement and Money Laundering Statutes," 37 *Cath. U.L. Rev.* 489, 491 (1988). See generally Peter E. Meltzer, "Keeping Drug Money from Reaching the Wash Cycle: A Guide to the Bank Secrecy Act," 108 *Banking L.J.* 230 (1991) (discussing the background of BSA and its purpose to prevent laundering of profits resulting from drug sales).

<sup>10</sup> 31 U.S.C. § 5312(a)(2)(A) (2003).

created.<sup>11</sup> As discussed below, the BSA still applies to financial institutions, but the scope of that term has been expanded to include 27 separately identified categories of financial institutions, which may include you and your clients.<sup>12</sup>

It is noteworthy that the obligation of persons engaged in real estate transactions to file a Currency Transaction Report pursuant to the BSA (when cash or cash equivalents in an amount over \$10,000.00 are used as the means of payment), predates the Act.<sup>13</sup>

### III. Summary of the Act and the Executive Order

#### A. The Act

##### (i) *Prohibitions & Requirements:*

1. Title III, §352 of the Act amended a number of provisions of the BSA to make it mandatory that all "financial institutions" have an anti-money laundering compliance program ("AMLP"), in place, which includes, at a minimum: (i) the development of internal policies, procedures and controls, (ii) the designation of a compliance officer, (iii) an ongoing employee training program, and (iv) an independent audit function to test programs.<sup>14</sup>
2. It is noteworthy that §352 does not itself impose any reporting requirements.<sup>15</sup>

##### (ii) *Who is covered:*

1. As noted above, the Act applies to "financial institutions" and includes a broad laundry list of institutions and individuals within that term.<sup>16</sup>
2. Of particular relevance to the real estate industry, the definition of a "financial institution" includes "persons involved in real estate closings and settlements."<sup>17</sup>

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<sup>11</sup> See, *Comprehensive Crime Control Act of 1984* (Public Law 98-473), *Money Laundering Control Act of 1986* (Public Law 99-570), *Anti-Drug Abuse Act of 1988* (Public Law 100-690), *Anunzio-Wylie Anti-Money Laundering Act* (Public Law 102-550), *Money Laundering Suppression Act of 1994* (Public Law 103-325), *Money Laundering and Financial Crimes Strategy Act* (Public Law 105-310).

<sup>12</sup> A financial institution (as defined in 31 U.S.C. §5312) is: An insured bank; A commercial bank or trust company; A private banker; An agency or branch of a foreign bank in the United States; A credit union; A thrift institution; A broker or dealer registered with the SEC; A broker or dealer in securities or commodities; An investment banker or investment company; A currency exchange; An issuer, redeemer, or cashier of travelers' checks, checks, money orders, or similar instruments; An operator of a credit card system; An insurance company; A dealer in precious metals, stones, or jewel; A pawnbroker; A loan or finance company; A travel agency; A licensed sender of money or any other person who engages as a business in the transmissions of funds; A telegraph company; A business engaged in vehicle sales, including automobile, airplane and boat sales; **Persons involved in real estate closings and settlements**; The United States Postal Service; An agency of the U.S. Government or of a State or local government carrying out a duty or power of a business described in this paragraph; A casino, gambling casino, or gaming establishment with an annual gaming revenue of more than \$1,000,000.00; Any business which engages in activities similar to those engaged in by the businesses described above; Any other business designated by the Secretary of the Treasury whose cash transactions have a high degree of usefulness in criminal, tax or regulatory matters.

<sup>13</sup> These transactions must be reported to FinCEN and the IRS using form 8300, (see *Anti-Money Laundering Programs for Financial Institutions*, 67 Fed. Reg. 67547 at 67548-49 (interim final rule November 6, 2002)).

<sup>14</sup> 31 U.S.C. §5318(h).

<sup>15</sup> Also note that §326 of the Act requires that financial institutions implement "reasonable and practicable" procedures to (i) verify the identity of any person opening an account, (ii) maintain records of the information used to verify the person's identity, and (iii) determine whether the person appears on any list of known or suspected terrorists or terrorist organizations (which would include the OFAC List). On May 9, 2003, the Treasury Department and other financial regulatory agencies issued interim final regulations implementing §326. The interim final regulations apply only to banks, savings associations, credit unions, certain non-federally regulated banks, securities brokers and dealers, mutual funds, future merchants and introducing brokers; they do not apply to any of the other financial institutions are defined by the Act.

<sup>16</sup> See note 13, *supra*.

3. The phrase “persons involved in real estate closings and settlements” is bereft of any meaningful legislative history. Neither the BSA, nor its legislative history define or elaborate on its meaning.<sup>18</sup> It is thus left to the Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”) to define this phase.<sup>19</sup>
4. In November 2002, the Treasury issued an interim final rule providing an indefinite exemption for certain financial institutions from the requirement of establishing an AMLP, which exemption includes “persons involved in real estate closings and settlements.”<sup>20</sup>
5. On April 10, 2003, the Treasury Department issued an Advance Notice of Proposed Rulemaking (“ANPR”) to solicit public comments on proposed anti-money laundering regulations under §352 of the Act, for financial institutions involved in real estate closings and settlements. According to the ANPR, the terms “persons involved in real estate closings and settlements” might reasonably include, among other persons, one or more attorneys, who represent the purchaser or the seller in a real estate transaction.
6. The ANPR identified the following four broad issues for public comment:
  - What are the money laundering risks in real estate closings and settlements?
  - How should persons involved in real estate closings and settlements be defined?
  - Should any persons involved in real estate closings or settlements be exempted from coverage under §352?
  - How should the anti-money laundering program requirement for persons involved in real estate closings and settlements be structured?
7. FinCEN received 52 comment letters from interested parties. The following is a brief summary of several practical, policy, and legal issues raised by various prominent bar-related and other professional organizations that submitted comments to FinCEN:
  - The American College of Real Estate Lawyers
    - FinCEN should develop a clear protocol whereby parties to a transaction may rely on written confirmation by another party to a transaction that it has performed §352 due diligence.
    - The AMLP procedures, including the independent audit function, are at odds with the attorney-client privilege.
    - Certain real estate transactions should be exempt if: (i) the transaction is below a significant amount of money, (ii) AMLP due diligence has previously been performed (i.e. securitization), (iii) real estate is not the principal asset being conveyed, or (iv) the transaction does not involve the conveyance of an interest in real estate at closing.

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<sup>17</sup> The “real estate” language originated in §6185(a) of the Anti-Drug Abuse Act of 1988. This language was added in subtitle E, known as the Money Laundering Prosecution Improvements Act of 1988. Pub. L. 100-690.

<sup>18</sup> Nor does the Act or its legislative history shed any light on the meaning of this phrase.

<sup>19</sup> The Secretary of the Treasury has delegated the authority to administer the BSA to the Director of FinCEN. 68 Fed. Reg., April 10, 2003. The Department of the Treasury created FinCEN in April 1990 by Treasury Order No. 105-08 as one of Treasury’s primary agencies to oversee and implement policies to prevent and detect money laundering.

<sup>20</sup> Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 67547 (interim final rule November 6, 2002).

- The Section of Real Property, Probate, and Trust Law of the American Bar Association
  - Imposing §352 AMLP requirements on lawyers would adversely affect the attorney-client privilege.
  - Section 352 requirements should be tailored so that, at most, it applies to lawyers who act as financial intermediaries that actually handle cash proceeds through accounts that they control ("Financial Intermediaries Test").
- The Section of Real Property, Probate and Trust Law of the Florida State Bar Association
  - Because of attorney-client privilege concerns, lawyers should not be subject to any AMLP requirements in any respect.
  - To impose the AMLP requirement on lawyers: (i) is duplicative (as the practices are already conducted by financial institutions), (ii) protracts the closing process, (iii) results in significant compliance fees, (iv) forces an attorney to conduct due diligence on its client and discourages clients from communicating frankly with their attorney; and (iv) imposes a de facto obligation on attorneys to report questionable transactions to authorities, which conflicts with rules of client confidentiality and attorney-client privilege.
- The ABA Task Force on Gatekeeper Regulation and the Profession
  - Emphasized the importance of the attorney-client privilege and the independence of the bar.
  - Is concerned that suspicious activity reporting requirements will soon follow.
  - Suggests the application of the AMLP requirements to lawyers be limited to a form similar to the Financial Intermediaries Test.
- The American Land Title Association
  - Urged FinCEN to proceed with caution and consider the practical problems of imposing AMLP requirements on solo practitioners and persons settling few transactions.
  - Stressed the limited evidence of money laundering in real estate transactions, which evidence does not justify the significant compliance burden.
- American College of Mortgage Attorneys
  - Attorneys should not be subject to any requirement under the Act.
  - Imposition of AMLP requirements on attorneys would “significantly—and determinately—alter the attorney-client relationship.”
  - Suggests an exception for secondary packaged, securitized transactions
- Mortgage Bankers Association of America

- The definition of "persons involved in real estate closings and settlements" should be limited to "those individuals who are directly responsible for conducting the real estate settlement or closing."
- The AMLP requirements would impose significant costs, burdens, and delays on the real estate industry, which are disproportionate to the harm being prevented.

(iii) *Penalties:*

1. U.S. businesses can commit both civil and criminal money laundering violations that can result in penalties of not less than twice the amount involved in the financial transaction, up to \$1,000,000.00, per violation.<sup>21</sup>
2. To satisfy the financial penalties, courts can issue a restraining order against property.
3. For individuals, the penalties for money laundering under the Act include imprisonment of up to 20 years and fines of at least twice the value of the property involved in the offense, up to \$500,000.00.

B. The Executive Order

(i) *Prohibitions & Requirements:*

1. Blocked Property Interests The Executive Order operates to freeze all property and property interests in the United States, or that come into the United States, of the following:
  - i. persons, groups or entities listed in an Annex to the Executive Order;
  - ii. property owners that are determined by the Secretary of State to have committed (or pose a significant risk of committing) acts of terrorism; and
  - iii. property owners determined by the Secretary of the Treasury to be owned, controlled by or acting on behalf of, any other persons, groups or entities blocked pursuant to the Executive Order (see the OFAC List).
2. Prohibited Transactions
  - a. The Executive Order prohibits any transaction or dealing by a "United States person"<sup>22</sup> or within the United States in property or property interests that are blocked under the Executive Order.
  - b. The Executive Order prohibits any donations by a "United States person" to any person or entity listed in the Order.
  - c. The Executive Order bars conducting any business of any kind with, and any donations of any kind to, any person or entity on the lists, and bars any support for or association with any person or entity on the OFAC List.
  - d. In June 2003, OFAC published interim final rules concerning the property of blocked persons.<sup>23</sup> The rules state that any property or interests in

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<sup>21</sup> See §363(b) of the Act.

<sup>22</sup> Defined as any United States citizen, permanent resident alien, entity (being a partnership, association, corporation, or other organization, group or subgroup) organized under the laws of the United States (including foreign branches), or any persons in the United States, see §3 of the Executive Order.

<sup>23</sup> 31 CFR 594.

property of blocked persons "that hereafter come within the United States, or that hereafter come within the possession or control of U.S. persons, including their overseas branches, are blocked and may not be transferred, paid, exported or otherwise dealt in."<sup>24</sup> The rules go on to state that "any transfer after the effective date that is in violation of [the rules] is null and void."<sup>25</sup>

- e. There are exceptions for unknowingly entering into transactions prohibited by the Executive Order, with no intent to violate the rules. However, in light of the availability of blocked person information provided on the OFAC List and through the available search engines, the "unknowing" standard may be hard to meet.<sup>26</sup>

(ii) *Who is Covered:*

The Executive Order applies to all U.S. persons and entities regardless of their trade or business, which includes lawyers and law firms and plainly applies to the real estate industry.

(iii) *Penalties:*

1. A civil penalty of up to \$11,000.00<sup>27</sup> may be administratively imposed on a person who violates the Executive Order.<sup>28</sup>
2. Upon conviction, a person who willfully violates the Executive Order shall be fined not more than \$50,000.00, and may be imprisoned for not more than ten years.<sup>29</sup>

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<sup>24</sup> 31 CFR §594.101.

<sup>25</sup> 31 CFR §594.202.

<sup>26</sup> There are several search engines available in order to conduct a search, e.g., the website of Charles Jones, LLC, <http://www.patriotnamesearch.com/TagX/oes/patriotns/>, provides a certified search for registered users for \$3 per name as well as reporting forms). In addition, the OFAC List may be viewed at <http://www.treas.gov/offices/eotffc/ofac/sdn/index.html>.

<sup>27</sup> This figure was adjusted from \$10,000.00 to account for inflation on October 23, 2003, see Fed. Reg. Vol. 68, No. 208.

<sup>28</sup> The Executive Order does not specifically provide penalties for a violation. However, the International Emergency Economic Powers Act ("IEEPA"), which the Executive Order was issued pursuant to, does provide penalties for violation of an order under the IEEPA (which includes the Executive Order), see 50 U.S.C. §1701.

<sup>29</sup> Any officer, director or agent of any corporation who knowingly participates in such a violation may be punished by a like fine, imprisonment or both. *Id.* at §1705