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Navigating the USA Patriot Act in Acquiring Title Insurance

By Alfred Santoro Jr.

In the aftermath of Sept. 11, the response to terrorism has clearly imposed itself on our individual lives. Heavy airport security, threat warnings and even caution over opening mail have become much more of a way of life here, as they have been overseas for many years.

This response has begun to change the way we as attorneys do business, even in a practice area so domestic as real estate. Checking for terrorists has become part of the business of obtaining title insurance.

With the enactment of the USA Patriot Act of 2001, P.L. 107-56, Congress moved to counter the sources of terrorist funds by requiring financial institutions to report financial transactions by those believed to be involved in terrorist activities.¹

Subsequently, President Bush issued Executive Order No. 13224 (amended by Order 13268), prohibiting “transactions with persons who commit, threaten to commit, or support terrorism.”² The Office of Foreign Asset Control (OFAC) of the U.S. Treasury Department is responsible for maintaining a list of “Specially Designated Nationals and Blocked Persons” (SDNs), published on the Internet at www.treas.gov/ofac.

The Patriot Act requires financial institutions — broadly defined as banks,

insurance companies, securities brokers-dealers, loan and finance companies and others — to develop and implement screening procedures and policies to implement its provisions.

Many title insurance agents are providing this information in connection with title insurance orders. Patriot Act name searches may be run separately or in conjunction with the searches customarily run as to state and federal court judgments during the course of a title examination.

Some title agents have chosen to run all names as a matter of course (as recommended by most title insurance underwriters). Since this practice is not yet uniform, it is suggested that Patriot Act searches be specifically requested at the time of placing a title insurance order.

Even if a lender does not require a judgment search, such as in the case of a cash transaction, Patriot Act searches are required, as they guard against prohibited transfers of assets. Both individual names and corporate names must be run.

A problematic aspect of a Patriot Act search is that the executive order’s language is so comprehensive. If a party to a transaction is considered to “be owned or controlled by, or to act for or on behalf” a person on the list, that party is covered by the blocking requirements. This might include corporations, partnerships, partners, principals, parent or subsidiary companies or other “parties” on whom checks are not usually run in real estate transactions. To the

extent that this information is known, these names should be searched against the database.

What’s in a Name?

Some names on the list may come as a surprise. They are *not* confined to any one particular race or nationality. Obviously, Osama Bin Laden appears, but so do names like Alejandro Angelini, Max Aregon, and Atlas Equipment Company Limited (as of March 21, 2003).

If the name of a person or entity with whom you are dealing appears on the list, you should first attempt to obtain additional information to aid in identifying the individual. First confirm that it is an exact hit. Does the name match exactly? Passport information, driver’s license information, address, and place of birth, will all aid in determining if this is a true hit or merely a false positive.

The OFAC has set out on its Web site (www.treas.gov/ofac) a checklist for determining the quality of a hit. Its 5-step due diligence procedure is as follows:

1. Is the hit or match against OFAC’s SDN list or targeted countries, or is it hitting for some other reason, or can you not tell what the hit is?

- If it’s hitting against OFAC’s SDN list or targeted countries, continue to step 2.

- If it’s hitting for some other reason, you should contact the keeper of whichever other list the match is hitting

The author is co-president of Esquire Title Services of Parsippany.

against.

- If you are unsure whom to contact, please contact your interdict software provider, which told you there was a hit.

- If you cannot tell what the hit is, you should contact your interdict software provider, which told you there was a hit.

2. Now that you've established that the hit is against OFAC's SDN list or targeted countries, you must evaluate the quality of the hit. Compare the name in your transactions with the name on the SDN list. Is the name in your transaction an individual, while the name on the SDN list is a vessel, organization or company (or vice-versa)?

- If yes, you do not have a valid match.

- If no, continue to step 3.

3. How much of the SDN's name is matching against the name in your transaction? Is it just one of two or more names matching (i.e., just the last name)?

- If yes, you do not have a valid match.

- If no, please continue to step 4.

4. Compare the complete SDN entry with all of the information you have on the matching name in your transaction. An SDN entry often will have, for example, a full name, address, nationality, passport, tax ID or cedula number, place of birth, date of birth, former names and aliases. Are you missing a lot of this information for the name in your transaction?

- If yes, go back and get more information and then compare your complete information against the SDN entry.

- If no, continue to step 5.

5. Are there a number of similarities or exact matches?

- If yes, call the hotline at 1-800-540-6322.

- If no, you do not have a valid match.

The OFAC instructs that you call the hotline if you have reason to know or believe that processing this transfer or operating this account would violate any of the regulations.

The OFAC takes the position that the president's executive order preempts any state regulation concerning

the obligation to issue an insurance policy. It further takes the position that the provision of an insurance policy to or on behalf of a blocked person is a violation of the executive orders. You are not allowed to provide any services to an SDN. If the SDN sends a deposit along with the application, you must block that payment.

In the event that the investigation cannot rule out the name as a false positive, the funds in question must be blocked. This means, according to the OFAC, "simply a way of controlling targeted property. Title to the blocked property remains with the target, but the exercise of powers and privileges normally associated with ownership is prohibited without authorization from the OFAC. Blocking immediately imposes an across-the-board prohibition against transfers or dealings of any kind with regard to the property."

This can be accomplished by placing the money into an interest bearing account. This account is under the immediate control of the OFAC, and no withdrawals may be made except at the direction of the OFAC. The OFAC must receive written notification within 10 days of any blocking action.

Who do these requirements affect? In short, probably everyone:

All U.S. persons must comply with the OFAC regulations, including all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, all U.S. incorporated entities and their foreign branches. For certain programs, such as those regarding Cuba and North Korea, all foreign subsidiaries owned or controlled by U.S. companies must also comply.

The fines for violations or noncompliance with the regulations can be substantial. Depending on the program, criminal penalties can include fines ranging from \$50,000 to \$10,000,000 and imprisonment ranging from 10 to 30 years for willful violations. Depending on the program, civil penalties range from \$11,000 to \$1,000,000 for each violation.

Tightening the Exemptions?

On April 10, the U.S. Treasury's

Financial Crimes Enforcement Network (FinCEN) published an advance notice of proposed rulemaking (68 Fed Reg. 17569, posted at www.fincen.gov/pa_main.html) and invited comments on or before June 9.

The notice says FinCEN is reconsidering its earlier temporary exemptions for persons involved in real estate closings and settlements from the requirement to establish anti-money laundering programs (Patriot Act §352, amending the Bank Security Act, 31 U.S.C. 5318(h)). FinCEN presented the following questions for comment:

First: What are the money laundering risks in real estate closings and settlements?

FinCEN notes in its proposal that real estate closings may be vulnerable to the money laundering process simply by virtue of dealing with high value products. It notes its own experience with money launders having used real estate transactions to disguise the illegal source of their proceeds. In particular, it identifies three stages where real estate transactions may become particularly susceptible to money laundering activities.

In the initial or placement stage of the process, the proceeds of illegal activity or funds intended to support illegal activity are placed into the financial system. This could occur in the purchase of real estate with a large cash down payment.

In the second stage of the money laundering process, funds are disguised or distanced from their illegal source. In a real estate transaction, this could occur when properties are bought, sold, exchanged or swapped.

The last or integration phase occurs when illegal funds appear to have been derived from a legitimate source. This could occur when property purchased with illegal funds is sold to a bona fide purchaser.

Second: How should persons involved in real estate closings and settlements be defined?

FinCEN notes in particular that "...attorney often play a key role in real estate closings and settlements and thus merit consideration along with all other professionals involved in the closing process." It continues that it does not

believe that "... the application of section 352 requirements (requiring parties to take steps to detect and prevent themselves from being abused by money launderers) to attorneys in connection with activities relating to real estate closings or settlements raises issues of or poses obligations inconsistent with, the attorney-client privilege."

FinCEN asks two more questions:

Third: Should any person involved in real estate closings or settlements be exempted from coverage under §352?

Fourth: How should the anti-money laundering program requirements for persons involved in real estate closings or settlements be structured?

These questions appear to be focused on avoiding a duplication of efforts and are in recognition of the fact that certain programs already exist with respect to anti-money laundering activities.

What does appear clear is that FinCen and the U.S. Treasury are concerned about the potential for abuse of

the real estate industry by sophisticated individuals and groups engaged in money laundering practices. They also appear to have decided that, at least for their purposes, arguments based on attorney client privilege and burdensome paperwork will not prevail. The real estate industry will have to adopt some cohesive system to deal with these issues as a whole or we will all have to do so individually. ■

FOOTNOTES:

¹ The act, actually entitled "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001" "grants federal officials greater powers to trace and intercept terrorists' communications both for law enforcement and foreign intelligence purposes. It reinforces federal anti-money laundering laws and regulations in an effort to deny terrorists the resources necessary for future attacks."...Congressional Research Service Report for Congress, April 15, 2002.

² Executive Order No. 13224 further provided that: "...all property and interests of the following

persons that are in the United States or that hereafter come within the United States, or that hereafter come within the possession, or control of the United States persons are blocked:

"a. Foreign persons listed in the Annex to this order;

"b. Foreign persons determined by the Secretary of the State, in consultation with the Secretary of the Treasury and the Attorney General, to have committed, or to pose a significant risk of committing acts of terrorism that threaten the security of U.S. nationals or the national security, foreign policy, or economy of the United States;

"c. Persons determined by the Secretary of the Treasury, in consultation with the Secretary of the State and the Attorney General, to be owned or controlled by, or to act for or on behalf of those persons listed in the Annex to this order...

"d. Persons determined... to assist in, sponsor, or provide financial, material, or technological support for, or financial or other services to, or in support of, such acts of terrorism, or those persons listed in the Annex to this order or determined to be subject to this order to be otherwise associated with those persons listed in the Annex to this order or those persons determined to be subject to...this order."