

Lawyers Should Advise Clients on the Perils of Providing ‘Proof of Funds’

BY RANDY LEE

Beyond their often-hasty willingness to pay far more than the asking price in the current fast-paced real estate market, today’s buyers are creating videos, sending photos, and writing “choose us” letters to encourage sellers to accept their offers. What they should not be doing is providing the now almost universally asked for proof-of-funds (POF) documentation, as part of a Purchase Offer or Binder package.

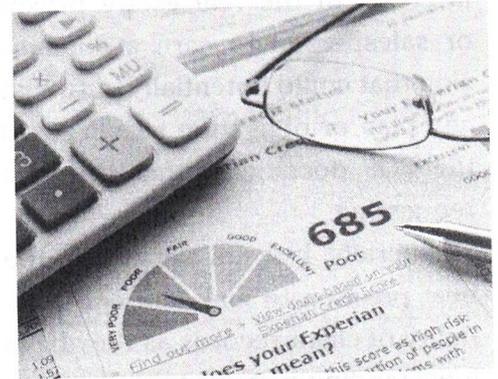
Simply put, the disclosure of sensitive financial documentation about one’s bank balances, brokerage accounts, net worth and income to real estate brokers, salespersons, and even sellers is a dangerous practice that can seriously jeopardize the privacy of the potential buyers and might very well open a pathway to identity theft and fraud. Without a doubt, sellers should be able to have a strong sense that the potential buyers can perform, but this should be a matter for the party’s lawyers to work out once an offer is accepted, and the deal is moving

to the contract stage of the transaction. There are many ways to verify a buyer’s ability to complete the transaction, in an all-cash, or even a mortgage-contingency transaction, and these can and should be able to be accomplished on a lawyer-to-lawyer basis, as part of the contract drafting and negotiation process. This can also be accomplished by the buyer providing reasonable POF to the seller’s lawyer along with standard specific confirmatory and binding representations and warranties in the contract.

For example:

- Buyers represent their current income(s) in an amount sufficient to obtain the mortgage that the contract may be contingent upon their obtaining.
- Buyers represent a stipulated minimum credit score (FICO) and covenant to not intentionally commit any acts or engage in a pattern of conduct that would act to adversely affect it during the contract period.
- Buyers represent sufficient cash/liquid assets currently on hand or available to complete the transaction.

Lawyers That Counsel Clients To Provide Proof of Funds May Be



Violating Their Ethical Duty. Lawyers who advise or permit their clients to provide hard POF documentation, other than general estimates, to real estate brokers, salespersons, or the seller to review may, certainly unintentionally, put their clients in unnecessary jeopardy, which they have a practical and ethical responsibility to avoid.

ABA Model Rule 1.6 requires lawyers to protect documents the lawyer is holding for clients and providing them to a real estate broker or salesperson, whose record keeping protocols are often non-existent and unverified, is contrary to this provision. In fact, Model Rule 1.6(a) specifically prohibits a lawyer from revealing “information relating to the representation of a client unless the client gives informed consent.” ABA Model Rule 1.6: Confidentiality of Information.

It is unlikely that a client would provide its informed consent for disclosure of POF documents if it were known that their lawyer could offer sufficient reasonable verification of the client's financial health by including provisions in a Purchase Offer or Binder package, as well as in the actual binding contract. This is especially true given the contrary interests of the real estate broker or salesperson to earn a commission that could potentially outweigh any plan or obligation to safeguard the POF documents that they are requesting.

Generally, lawyers are also in the best position to maintain confidentiality of client records as they have longstanding systems to protect private and sensitive information that a real estate professional typically cannot match.

A Broker's Obligations Do Not Override a Lawyer's Judgment.

Real estate brokers and salespersons have a fiduciary duty and potential contractual obligations to maintain confidentiality, exercise reasonable care, and engage fairly and in good faith. A breach of these duties could result in liability for damages. In addition, the New York State Real Estate Board's professional conduct guidelines prohibit brokers from disclosing confidential information. A violation could similarly impact a broker's license. Real Estate Board of New York, Code of Ethics and Professional Practices B (3) (2019).

Ill intentions are not, however, the primary concern here; rather, their

infrastructure, written established policies and protocols, and ability to secure, protect, and then dispose of POF documentation is the greatest concern. And then we come to the seller, who has virtually no obligation whatsoever to safeguard POF documentation.

Although the New York Real Property Law requires a real estate agent to disclose any information to the seller that materially affects a buyer's ability or willingness to perform, which includes POF (see N.Y. Real Prop. Law §443 (Laws of New York 2021)), it does not mandate any specific records management protocols to ensure the confidentiality of those records. Given the fast-paced nature of real estate, offering bank statements, securities statements, tax returns, and other specific financial data is a significant risk for the buyer, with a remote consequence for the seller. As a result, the lawyer for the buyer should instruct its client to avoid the issue completely. Bluntly, POF documentation should be off the table at the Purchase Offer or Binder stage.

After all, in a high-stakes market that is rapidly changing, real estate professionals are working overtime to maximize the returns for their clients and their firms. Many are operating from home and unavoidably scanning, faxing and/or printing sensitive records on their personal or all-in-one devices or printers, likely commingling highly confidential files with unrelated paperwork in a home office, or even a makeshift office in another location in their

house or on non-exclusive shared desk in an office, with few, if any protections. Most even fail to implement industry-standard security protocols for digital records, sharing these unencrypted documents via email, fax, or portable media without any safeguards.

It should be noted that a seller's agent who works for a broker that is licensed to provide mortgages or property appraisals would need to have data security measures, an incident response plan for unauthorized access to their records, and a data destruction and retention policy under Gramm-Leach-Bliley. 15 U.S.C.A. §§6801 et seq. The New York SHIELD (Stop Hacks and Improve Electronic Data Security) Act further requires any person or business handling state residents' private information, including financial account numbers when the sales transaction permits access to them, to use reasonable administrative, physical, and technical safeguards to protect its security, confidentiality, and integrity. N.Y. Gen. Bus. L. § 899-bb.

That said, the New York attorney general enforces the SHIELD Act and there is no private right of action. So, while the bones of some level of protection exists for real estate brokers that offer mortgages or appraisals, the question is whether the real estate sales divisions is required to follow Gramm-Leach-Bliley or and the New York SHIELD Act. It seems unlikely.

Good Faith and Protecting the Proof. While a buyer's agent must

exercise reasonable skill and care in performing its duties with honesty, fairness, and in good faith, which includes disclosing the client's ability to make the purchase and protect that information (see N.Y. Real Prop. Law §443 (Laws of New York 2021)), there is no specific requirement to provide sensitive personal data.

In fact, the seller's agent should not want to take this risk either because a licensed real estate salesperson, broker, or employee of a broker can have their license suspended or revoked for knowingly violating any provision of Article 12 of the New York Real Property Law. N.Y. Real Prop. Law §§442-c, 443 (Laws of New York 2021). While licensed brokers must retain records, such as the purchase contract or binder, of each transaction for three years, there is no reason to receive or retain the POF documentation after the contract signing process has started. N.Y. Comp. Codes R. & Regs. tit. 19, §175.23 (2021).

Proof, Purchasing, and Providing an Alternative. It is important to recognize that a broker may not refuse to transmit an offer without POF documentation. The New York Code of Ethics and Standards of Practice of the National Association of Realtors dictates that listing brokers and buyers' agents must submit all offers and counteroffers until closing unless the seller waives the obligation in writing. Code of Ethics and Standards of Practice of the National Association of Realtors, arts. 1-7, 1-8 (2021). This includes reporting the buyer's willingness to sign a

contract and refusal to submit POF documentation with the offer. It is up to the sellers and their lawyer to determine the buyer's ability to perform once the offer has been submitted.

Lawyers should be prepared to zealously defend clients who meet the spirit of this obligation without unnecessarily risking disclosure of their most sensitive financial details. The offers of their clients should be treated with equal weight and presented alongside others with varying levels of documentation. If the seller's broker refuses, then counsel for the buyer should consider litigation against the broker and other adversarial options to ensure fair dealing.

Conclusion

In a weak real estate market, desperate sellers may agree to an array of concessions, but in 2021, when buyers are routinely bidding above the asking price with all cash offers and even forgoing a physical visit to an attractive property, those interested in a particular listing may feel pressured to provide excessive POF documentation to earn maximum consideration. This is a mistake that real estate lawyers should strongly counsel their clients to avoid it.

The emphasis on privacy and data protection has never been more significant. While brokers and sellers are able to set the parameters by which buyers must operate and are bound by a formal and/or implied duty to safeguard all records associated with each offer, they lack the comprehensive structure,

protocols, and longstanding ethical obligation to actually do so.

Sellers should focus on assurances, rather than record keeping. To satisfy the need for verification, buyers should not provide an invasive and overreaching look into their finances. Instead, they should give the seller enough information to quell any doubt that they can consummate the transaction.

Perhaps a standard bank letter attesting to a buyer's financial health might be adequate proof. "Comfort letters" from accounting or law firms verifying that a buyer has sufficient financial strength or support are also routinely used in many business transactions.

The era of giving POF is over. The practice is outdated and should be outlawed. Lawyers are the first and last line of defense in this battle.

Randy Lee is a real estate lawyer who focuses on representing builders, developers and investors throughout the NYC metro area. He is a Chairman Emeritus of the Staten Island Economic Development Corporation and retired as the longstanding Chairman of the Building Industry Association of NYC, and many times has served as the Chairperson of the well regarded Legal Action Committee of the National Association of Home Builders and is a founder of its LANDS program.

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