



Choosing the Right Qualified Intermediary: Key Factors to Consider to Safeguard Your Funds

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The sale of rental, investment or business use real estate is often one of the largest financial transactions an investor will undertake. When investors choose to structure their sale as a 1031 exchange to defer the payment of capital gain taxes, they entrust their net proceeds from the sale of their relinquished property to a third party known as a qualified intermediary (QI), sometimes referred to as an accommodator or facilitator, such as Exeter 1031 Exchange Services, LLC ([Exeter1031™](#)).

The qualified intermediary holds the investors' 1031 exchange funds throughout the 1031 exchange process, prepares the documentation to structure the 1031 exchange and integrates the sale of the relinquished property into the 1031 exchange, and ensures the 1031 exchange transaction complies with Section 1031 of the Internal Revenue Code (IRC) and the corresponding Section 1.1031 of the Treasury Regulations.

Given the magnitude of the amount of funds held by qualified intermediaries on behalf of investors' 1031 exchange transactions, investors generally assume that the government heavily scrutinizes qualified intermediaries. The assumption is that qualified intermediaries are licensed and regulated, undergo mandatory audits or exams, carry bonding and insurance and maintain a certain level of regulatory required equity capital. **Unfortunately, for most qualified intermediaries, this is not the case.**

Selecting the right partner for a 1031 exchange requires rigorous and careful due diligence. This guide will walk investors through how to analyze and select a qualified intermediary to ensure their funds remain safe and their tax-deferred status remains intact.

The Reality of an Unregulated Industry

The most shocking fact for many investors is that the 1031 exchange industry is unlicensed and unregulated. The 1031 exchange qualified intermediary industry generally has no licensing requirements, no regulatory oversight capabilities, and no bonding, insurance or minimum equity capital requirements. The Internal Revenue Service (IRS) sets the rules for how a 1031 exchange must be completed, but they do not regulate the qualified intermediaries that facilitate them.

In most states, there is no licensing requirement to operate as a qualified intermediary. There is no regulatory oversight, no mandatory bonding or insurance requirement, and no obligation to maintain any level of minimum equity capital reserves. Essentially, anyone can print business cards and claim to be a qualified intermediary.

Because of this lack of oversight, most QIs are never audited by a government agency or a third-party certified public accounting (CPA) firm. They operate without the safety nets that investors typically expect from regulated financial institutions. When evaluating a potential partner, the first question should not be about fees, but about safety: Is this qualified intermediary licensed, regulated, audited and bonded or insured? Do they have substantial equity capital reserves?



The Risks of Using an Unregulated Qualified Intermediary

The danger of using an unregulated 1031 exchange company is not theoretical; it is a lesson learned through significant financial losses in the industry's history. The most prominent example is the collapse of LandAmerica 1031 Exchange Services during the Great Recession.

The LandAmerica 1031 Exchange Bankruptcy Case

In 2008, LandAmerica, one of the largest title insurance companies and qualified intermediaries in the nation, filed for bankruptcy protection. Many investors assumed their funds were safe because LandAmerica was a large, publicly traded company. However, LandAmerica 1031 Exchange Services was not a bank or trust company and was not subject to the strict investment restrictions that govern regulated financial institutions.

LandAmerica 1031 Exchange had invested investors' exchange funds into auction rate securities—long-term, illiquid investments—in an attempt to generate higher yields for the company. When the credit markets froze, those funds became inaccessible. Investors could not close on the purchase of their replacement properties, and when the company collapsed, hundreds of millions of dollars in client funds were frozen or lost.

This case underscores a critical reality: the size of the qualified intermediary does not equal safety. Without regulatory oversight restricting how client funds are invested, an unregulated QI may take unnecessary risks with investors' 1031 exchange funds.

Why Investors Must Choose a Regulated Qualified Intermediary

To mitigate these risks, investors should seek out a qualified intermediary that voluntarily subjects itself to [regulatory oversight](#) or is structured as a regulated entity, such as a bank or [trust company](#).

A regulated qualified intermediary offers a layer of protection that unregulated competitors cannot match. Here is what investors should look for when evaluating and selecting a qualified intermediary:

Government Oversight and Audits

A regulated qualified intermediary is answerable to a government body, such as a state department of banking or division of financial institutions. These agencies conduct surprise regulatory exams to ensure the company is complying with fiduciary standards and is operating in a safe and sound manner. Furthermore, these regulated entities generally undergo annual independent audits by reputable CPA firms to verify their financial health, internal controls and processes.

Minimum Equity Capital Requirements

Regulatory bodies often require license holders to maintain specific levels of legitimate equity capital reserves. This "skin in the game" ensures the company has the financial strength to weather economic downturns without dipping into investor funds. Unregulated QIs effectively have no minimum equity capital requirements, meaning they could be operating while technically insolvent.

Evaluating Financial Strength, Bonding and Insurance

Once it has been determined that the potential qualified intermediary is licensed, regulated and examined by a regulatory body, the investor must analyze the QI's specific [financial strength and stability](#). Do not rely on verbal assurances, request copies of their insurance binders and proof of coverage. In short, trust but verify.

Fidelity Bond

Fidelity bonds protect investors against criminal acts, such as theft, embezzlement, misappropriation or fraud committed by the employees of the qualified intermediary. In an industry where millions of dollars move daily, a robust fidelity bond is non-negotiable.



Errors and Omissions (E&O) Insurance

Even the most experienced professionals can make mistakes. Errors and omissions insurance or E&O insurance protects investors' interests if the qualified intermediary commits an error or omission during the administration of the 1031 exchange that results in a financial loss or tax liability.

Cyber or Wire Fraud Insurance

Cyber and wire fraud have become perhaps the biggest risk today in the financial services industry. It is not a question of will the investor get hit, but when and how hard. The QI should have cyber and wire fraud insurance to protect investors should the QI become a victim to a cyber or wire fraud incident.

Corporate Surety Bonds

Some states require specific corporate surety bonds for QIs operating within their jurisdiction. These bonds provide an additional layer of financial recourse for the consumer.

When evaluating these policies, look at the dollar amount of the coverage. Is it sufficient to cover the volume of transactions the company handles? A policy worth \$1 million offers little protection if the company holds \$50 million in client deposits.

The Importance of Technical Experience and Expertise

Financial safety is paramount, but technical competence is equally critical. The rules governing Section 1031 of the Internal Revenue Code are complex and unforgiving. A simple error in the documentation or timing can disqualify the entire 1031 exchange, leading to an immediate and substantial tax bill.

Investors need a team that acts as more than just a processing center. The investor needs a qualified intermediary that can provide consultative guidance in conjunction with their legal, tax and financial advisors.

Specialized Knowledge

Does the qualified intermediary specialize in 1031 exchanges, or is it a sideline business for a title company or bank? 1031 specialists are far more likely to be up-to-date on the latest Treasury Regulations, Revenue Procedures, Revenue Rulings, and Private Letter Rulings.

Handling Complex Transactions

Ask about their experience and expertise with non-standard exchanges. Can they handle reverse 1031 exchanges? What about improvement (build-to-suit) 1031 exchanges, leasehold improvement 1031 exchanges, foreign property 1031 exchanges, or even zero equity 1031 exchanges? Even if the current transaction seems simple, utilizing a firm with the expertise to handle complex scenarios ensures they have the depth of knowledge to solve problems if the transaction hits a snag.

Accessibility: The Value of a Human Connection

In an era of automation, call centers and artificial intelligence (AI), the ability to reach a knowledgeable human being is a vital component of the due diligence process. A 1031 exchange operates on strict deadlines—specifically the 45 calendar day identification period and the 180 calendar day exchange period. Investors cannot afford to wait 48 hours for an email response or get stuck in a phone tree when a deadline is looming.

Direct Access to Expertise

Test their accessibility before retaining the qualified intermediary. Call their main phone line. Does a machine answer, or does a person answer? Can callers speak directly with their exchange officer, or are they routed to a general support queue?



Access to Executive Leadership

In moments of crisis or high complexity, investors may need answers from the top. A quality, professional qualified intermediary provides clients with access to executive leadership. Knowing that investors can escalate an issue to a decision-maker who has the authority to resolve problems provides peace of mind that is invaluable during a high-stakes real estate closing.

Due Diligence Checklist

To summarize, when interviewing a qualified intermediary, use this checklist to verify their qualifications:

- **Regulatory Status:** Are they licensed, regulated, and examined by a government agency?
- **Audit History:** Do they undergo annual independent CPA audits?
- **Equity Capital Reserves:** Do they maintain regulatory mandated minimum equity capital reserves?
- **Insurance:** Do they hold sufficient Fidelity Bond, E&O insurance and cyber and wire fraud insurance coverage to better protect investors?
- **Funds Safety:** Do they use separate, segregated, dual-signature, restricted qualified trust accounts or qualified escrow accounts to protect investors' funds?
- **Expertise:** Do they have a dedicated team of 1031 exchange specialists with decades of experience?
- **Accessibility:** Can the investor reach a live person and access executive leadership easily?

Conclusion

The selection of a qualified intermediary is not a decision to be taken lightly or based solely on who offers the lowest fee. The safety of the investors' 1031 exchange funds and the security of the tax deferral depend entirely on the reliability of the firm chosen.

By prioritizing licensed, regulated, and audited companies, investors protect themselves against the systemic risks present in this largely unregulated industry. Demand transparency, verify insurance, and ensure the selected partner has the financial strength and technical expertise to guide the parties safely to the finish line.

Next Steps – Choose a Regulated QI

When preparing for a 1031 exchange, ensure that the funds are held, safeguarded, and protected by a licensed, regulated, audited, well capitalized and experienced partner, such as Exeter Trust Company (ExeterTrust™). Exeter Trust Company is licensed, regulated and examined by the Wyoming Division of Banking. Feel free to reach out and ask any questions of Exeter 1031 Exchange Services, LLC or Exeter Trust Company. Our team of 1031 exchange specialists are ready to answer questions and provide any documentation needed to complete the due diligence process with confidence. [Go Ahead, ASK! We have answers!](#)