



The Hidden Risks of Using Unregulated 1031 Exchange Qualified Intermediaries

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When investors structure a 1031 exchange, they entrust a qualified intermediary (QI), sometimes referred to as an accommodator or facilitator, with the net proceeds from the sale of their relinquished property. This financial transfer often represents a significant portion of an investor's life savings. Investors assume the entities holding their millions are strictly licensed, heavily regulated, and routinely audited by government agencies.

Unfortunately, that assumption is wrong.

The 1031 exchange qualified intermediary industry has no licensing or regulatory oversight capabilities; the industry is not licensed nor regulated. Choosing the wrong 1031 qualified intermediary can expose the investor's equity capital and taxable gains to significant risks.

This post breaks down the current state of QI licensing, the severe dangers of working with entities that are not licensed or regulated, historical examples of three catastrophic 1031 exchange company failures, and how to properly safeguard investors' exchange funds. Investors will discover why partnering with a licensed and regulated 1031 exchange QI, such as [Exeter 1031 Exchange Services, LLC](#) (Exeter1031™), is crucial to safeguarding their 1031 exchange funds. Investors can also read our post entitled "[Qualified Intermediaries Are Not Created Equal.](#)"

The Current State of QI Regulation

When assessing a qualified intermediary, investors must understand the regulatory landscape. Investors are often shocked to learn that there is absolutely no federal licensing, regulation, or oversight required to operate as a 1031 exchange QI. Anyone can set up a business and begin holding millions of dollars in client funds without any federal scrutiny.

While the federal government remains silent on QI licensing, only a handful of states have stepped in to provide any kind of minimum standards. States like Nevada, Washington, Idaho, Maine, Colorado, Virginia, and California have enacted varying levels of minimal legislation addressing QIs. We stress minimal because the various legislative initiatives that have been passed to date will provide little to no assistance to investors when there is a complete QI failure.

Only a small number of states have implemented their own regulations for QIs. These requirements vary significantly by location, but do not provide any form of true regulatory oversight or any type of independent regulatory exam that is so crucial to ensure that the exchange QI is operating in a safe and sound manner.

There are only a couple of states—including Idaho, Maine, Nevada, and Virginia—that have imposed any kind of specific legal, certification or registration standards on QIs. It should be noted that Nevada has since repealed their "registration" requirement for qualified intermediaries.



Some of these states, like California and Colorado, do not require a "license" but do mandate that QIs maintain minimal levels of fidelity bond (often \$1 million or less) and Errors & Omissions (E&O) insurance coverage in order to operate a 1031 exchange business. However, these "minimal" levels of insurance required are completely insufficient for the transaction volume and aggregate amount of funds administered and held by qualified intermediaries.

In every case, there is a general lack of independent oversight. Anyone who is not a "disqualified person" can set up shop and act as a 1031 exchange qualified intermediary without a license, test, or regulatory hurdle. This is incredibly scary when you consider the amount of total funds being held by a qualified intermediary.

These state-level regulations typically require intermediaries to maintain fidelity bonds, carry errors and omissions (E&O) insurance, and hold client funds in separate, segregated escrow accounts rather than commingling them with operating funds. However, even in these states, the oversight falls extremely short of comprehensive regulated oversight and independent exams. If investors are operating outside of these specific states, their state government likely provides zero oversight of the QI.

The lack of federal regulation means that investors must carefully vet intermediaries themselves. If a QI mismanages funds or goes bankrupt (see specific examples below), investors can lose both their money and their tax-deferred status, leading to the immediate recognition of their taxable gain.

Why Regulatory Oversight Matters

Licensing and regulatory oversight act as the primary defense mechanism for investors' equity capital. A regulated intermediary is held to a much higher standard and strict financial guidelines that dictate exactly how they can and cannot administer the 1031 exchange funds compared to other unlicensed and unregulated QIs.

Regulated oversight ensures that qualified intermediaries hold investor funds separate and apart from corporate accounts and undergo regular examinations to ensure the organization is following the regulatory requirements. This structural discipline prevents a QI from taking unwarranted risks with the 1031 money. When a regulatory body routinely examines an institution, it creates a transparent environment where financial discrepancies are caught early. Without this oversight, investors rely entirely on the unverified promises of the qualified intermediary.

The Hidden Risks of Unregulated Intermediaries

Working with a non-licensed and non-regulated QI exposes investors to massive financial hazards. Without any regulatory constraints, an intermediary can legally pool investors' exchange proceeds with their own corporate operating funds, or worse, using investors' 1031 funds for the QI's own personal gain.

This lack of restriction allows unscrupulous or financially desperate QIs to invest client funds in high-risk, illiquid assets to generate higher yields for themselves. If the market turns, the QI may not be able to return the 1031 funds when needed to close on the purchase of the investor's replacement property. This failure not only results in the loss of the original capital but also triggers a massive, unexpected tax liability because the 1031 exchange has failed since it was not completed within the strict 180-calendar day exchange window.

History Lessons: When Unregulated QIs Fail

The exchange industry has witnessed several catastrophic failures of intermediaries that were not licensed nor regulated. These failures and/or bankruptcies highlight the devastating consequences of trusting unverified 1031 exchange QIs.

The Fraud of Edward H. Okun and The 1031 Tax Group LLP

One of the largest and most notorious examples of the consequences stemming from a lack of regulatory oversight was the collapse of The 1031 Tax Group LLP, owned by Edward H. Okun. From 2005 to 2007, Okun systematically



misappropriated more than \$100 million in client exchange funds to finance personal business ventures, his own real estate investments and sustain his lavish lifestyle. Instead of safeguarding exchangers' proceeds in secure and properly segregated accounts, Okun diverted funds, using new clients' money to meet the obligations of earlier exchange agreements, a classic example of a Ponzi scheme.

The deception unraveled in 2007 when The 1031 Tax Group filed for bankruptcy, leaving hundreds of investors unable to complete their real property exchanges and facing substantial lost principal and tax liabilities. Okun's fraudulent activities led to his conviction on multiple counts of wire fraud, money laundering, and conspiracy, and he was sentenced to 100 years in federal prison. The Okun case underscores the critical role that regulation, independent audits, and strict custody protocols play in protecting client assets. Had robust oversight and examination existed in this case, the misappropriation of funds would have been quickly identified and halted, sparing investors from devastating losses.

The Fall of LandAmerica

The LandAmerica 1031 Exchange Services bankruptcy in 2008 is the definitive cautionary tale for the industry. LandAmerica was the third largest title insurance company and was one of the largest QIs in the country. They often told clients they were too big to fail. They were a mainstream financial failure that directly exposed the lack of regulation and the risks of how qualified intermediaries handle client funds.

To generate higher returns, its QI invested hundreds of millions of dollars of client exchange funds into auction-rate securities. When the global financial markets froze in 2008, these auction-rate securities became completely illiquid.

LandAmerica 1031 Exchange was effectively forced into a "Ponzi" scheme. Because the 1031 funds were frozen in the auction-rate securities, LandAmerica 1031 could not access the cash needed to fund their clients' replacement property closings. The company was forced to use money from new incoming exchange transactions to pay for existing clients who needed to close on the purchase of their replacement properties. As the real estate market worsened, the company was forced to use corporate capital to cover purchases of replacement properties for its clients.

When they could no longer keep up with the demand of replacement properties, they were forced to file for bankruptcy protection, freezing the funds of hundreds of 1031 investors and leaving them unable to complete their exchanges. Because the funds were not held in separate, segregated, qualified trust accounts, the bankruptcy court ruled that the exchangers were unsecured creditors (i.e., the funds were essentially treated as corporate funds and not client trust funds). Many investors lost their life savings and faced devastating tax bills. Proper regulatory oversight regarding liquidity and fund segregation would have entirely prevented this qualified intermediary failure.

Key Takeaways from the LandAmerica Failure

The LandAmerica 1031 Exchange case highlighted two critical legal realities that still exist today because there is no federal licensing or regulatory oversight of qualified intermediaries.

The bankruptcy court ruled that unless exchange agreements were specifically drafted to create a trust or escrow arrangement, the exchange funds became part of the QI's bankruptcy estate. This meant investors were treated as "general unsecured creditors" rather than owners of their own money. This is why the use of [qualified trust accounts](#) or qualified escrow accounts has always been so critically important.

In direct response to the LandAmerica 1031 Exchange failure, the IRS issued Revenue Procedure 2010-14 as a "safe harbor" to help those investors that were affected by the LandAmerica 1031 Exchange failure. It allows investors (taxpayers) who lose money to a bankrupt QI to defer the payment of their tax liability until they actually receive a



payment from the bankruptcy estate, rather than being hit with a massive tax bill immediately upon the qualified intermediary's failure.

The Collapse of Southwest 1031

Southwest Exchange Corporation presents another tragic example. In this case, the failure stemmed from outright fraud and a lack of oversight. The executives systematically drained millions of dollars from client accounts to fund personal investments and lavish lifestyles.

Because Southwest 1031 operated without routine CPA audits or regulatory examinations, the theft went unnoticed for years. By the time the company collapsed, nearly \$100 million in client funds had vanished. Had Southwest 1031 been subject to the stringent, unannounced examinations required of regulated financial institutions, the theft would have been exposed immediately.

The Truth About Written Guarantees

A few QIs that are not directly licensed, regulated or audited attempt to ease investor concerns by offering "written performance guarantees" backed by their parent companies or insurance affiliates. On the surface, these documents look reassuring. In reality, they are essentially worthless during a financial crisis.

The LandAmerica 1031 Exchange Services bankruptcy is the case that proved "written guarantees" can be paper-thin in a court of law. In that case, the bankruptcy court ruled that even though LandAmerica provided clients with a signed, written guarantee of the availability of their funds, those funds were not held in a true trust. Instead, they were considered part of the QI's general bankruptcy estate.

A corporate guarantee is only as strong as the financial health of the company issuing it. In the LandAmerica case, the parent company, LandAmerica Financial Group, issued written guarantees protecting the 1031 exchange funds. However, the parent company was also heavily exposed to the 2008 financial crisis and filed for bankruptcy alongside its QI subsidiary. The "guarantee" was an empty promise from an insolvent entity. The court dismantled these guarantees. True security comes from structural regulation and fund segregation, not a piece of paper from an unregulated corporation.

Why the Guarantee Failed

The failure of the LandAmerica guarantee came down to "dominion and control."

The exchange agreements allowed LandAmerica to "do as it pleased" with the exchange funds, including investing the 1031 funds in risky auction rate securities. The funds were not held in separate, segregated, dual-signature, restricted qualified trust accounts or qualified escrow accounts as permitted by the Treasury Regulations.

Even when funds were in "segregated" accounts with the investor's name referenced on the accounts, the accounts were titled in the name of the qualified intermediary. The court ruled that without specific "trust" language in the contract, the QI legally owned the money, and the investor was just a "general unsecured creditor".

Courts later noted that because a major corporate bankruptcy was not "reasonably foreseeable" at the time of the contracts, the guarantees didn't provide the protection investors thought they were buying.

The Trust Company-Regulated Advantage

Given the significant financial risks, investors should exclusively utilize QIs that are licensed, regulated, and subject to strict regulatory oversight and periodic independent audits. While the service of being a 1031 qualified intermediary is not federally licensed, some firms have proactively chosen to operate under a licensed and [regulated corporate structure](#), such as a trust company or bank.



These specific entities are often viewed as the "gold standard" for security because they are subject to government oversight that most standalone QIs never face. The highest standard of protection belongs to intermediaries structured as, or owned by, licensed trust companies or banks.

When a QI operates under a trust company or bank charter, it falls under the direct supervision of federal or state banking regulators. These banking authorities enforce strict minimum equity capitalization requirements, mandate the use of separate, segregated, dual-signature, restricted fiduciary accounts, and prohibit the risky investment of client funds. In this structure, the 1031 exchange money is held in a true fiduciary capacity, meaning it belongs to the investor—not the institution. If the institution were to fail, the funds are protected from the institution's creditors.

Why Licensing Matters

When a QI is a trust company or bank, they aren't just promising to be safe; they are legally bound by banking and fiduciary laws and regulations that include:

- Frequent, unannounced regulatory exams by state or federal banking regulators;
- Independent audits of its financial statements by outside, independent certified public accountants;
- Independent audits of its policies and procedures also by outside, independent certified public accountants;
- Strict rules on where and how they can invest "other people's money," which would have prevented the three qualified intermediary failures discussed above.
- Minimum insurance requirements, including fidelity bond, errors and omissions insurance, and cyber and wire fraud insurance protections;
- Minimum regulatory required equity capital reserves to protect investors against losses that are not covered by the insurance coverages mentioned above.

Trust companies and banks have a higher legal "fiduciary" standard of care compared to a standard contract-based qualified intermediary.

The Crucial Role of Independent Audits

The final layer of security comes from continuous, independent verification through exams and audits. It is not enough for a 1031 exchange qualified intermediary to simply claim they follow best practices; they must prove it through routine examinations.

Bank regulatory exams are unannounced and incredibly thorough. Regulators assess the institution's financial stability, operational controls, and compliance with fiduciary laws. Furthermore, top-tier QIs submit to rigorous, independent CPA audits. These audits verify that all client funds are accounted for, properly segregated, and held in secure, liquid accounts. A QI that embraces both regulatory exams and independent CPA audits demonstrates a commitment to transparency and client security that unregulated entities simply cannot match.

Next Steps for a Secure Exchange

Investors' 1031 exchange funds deserve the highest level of protection available. Never assume a QI is licensed, regulated or audited simply because they have a professional website or a large parent company.



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Before committing funds to a specific QI, ask the intermediary for proof of their regulatory status. Ask for copies of their fidelity bond, E&O insurance, cyber and wire fraud, and their latest independent CPA audit. If conducting due diligence for a corporate or institutional 1031 exchange, demand the security of a trust company or bank-regulated qualified intermediary. Investors should protect their wealth by partnering with an institution that prioritizes safety and soundness, credibility, expertise, and structural assurance.