

FINANCIAL SERVICES

U.S. TREASURY EXTENDS BANK SECRECY ACT REQUIREMENTS TO NON-BANK MORTGAGE LENDERS AND ORIGINATORS

by: John K. Lawrence

The U. S. Treasury's Financial Crimes Enforcement Network ("FinCEN") has issued final regulations imposing on non-bank residential mortgage lenders and originators ("RMLOs") the anti-money laundering ("AML") and suspicious activity reporting ("SAR") requirements of the Bank Secrecy Act. The new regulations rescind a "temporary" exemption that has been in place since 2002, and will require adoption of AML programs and, potentially, changes to operating procedures, by RMLOs. The new regulations become effective on April 16, 2012, although the compliance date for implementation of an AML program and filing of SARs is August 13, 2012.

Background

The Bank Secrecy Act ("BSA") authorizes the Secretary of the Treasury to require financial institutions to keep records and file reports that have a high degree of usefulness in criminal, tax or regulatory investigations or in the conduct of intelligence or counterintelligence activities relating to international terrorism. The Secretary is also authorized to impose AML program requirements on financial institutions. These functions are conducted on behalf of the Secretary by FinCEN, a bureau of the Treasury Department.

Since 2002, FinCEN has exempted "loan or finance companies" from these BSA requirements. The new regulations end that exemption for one category of loan or finance companies, namely non-bank RMLOs. FinCEN has indicated that the new rules are a first step in a gradual extension of the regulations to additional categories of loan or finance companies.

Scope

The new regulations apply to non-bank residential mortgage lenders and originators; that is, persons engaged in specific activities related to residential mortgage loans. This group is broader than its name might imply, because the term "residential mortgage loan" encompasses not only loans secured by residential real property (including condominium and cooperative units) and real estate on which a 1-4 family residential structure is intended to be constructed, but also loans secured by a mobile home or trailer used as a residence.

A lender includes the person to whom debt on a residential mortgage loan is initially payable, or to whom the borrower's obligation is initially assigned at or immediately after settlement. An originator includes a person who accepts a residential mortgage loan application (either for itself or for another person), even if it does not negotiate the terms of the loan, and also a person who offers or negotiates terms of a such a mortgage loan, regardless of whether it also accepts a mortgage loan application.

The new regulations apply to all non-bank RMLOs, regardless of their form of organization, number of employees, or the dollar amount or volume of transactions they conduct. Sole proprietorships (that is, businesses not conducted through an entity form) are expressly covered. The regulations exclude from coverage banks, persons registered with or examined by the SEC or the CFTC, government-sponsored enterprises regulated by the FHFA, and Federal and State agencies administering mortgage or housing assistance, fraud prevention or foreclosure prevention programs. The regulations also do not apply directly to individuals employed by an RMLO, or to individuals financing the sale of their own real estate.

Anti-Money Laundering Program

Implementation of the AML requirements by each RMLO may involve significant effort, as they include several specific elements. Those elements include (a) obtaining specific information in connection with each transaction, (b) recordkeeping, (c) adoption of risk-based written policies, procedures and internal controls, (d) designation of a responsible compliance officer, (e) provision of ongoing training of staff (and non-employee agents and brokers, if used) regarding AML program requirements, and (f) provision of periodic independent testing to monitor and maintain an adequate AML program. Supervision of the implementation effort by senior management will be advisable.

The transactional information and recordkeeping requirements of the AML program primarily address identification of the RMLO's customer and other parties, if any, to specified forms of transactions, and the terms of those transactions. Such records must be retrievable in certain ways and be retained for five years.

Required written policies, procedures, and internal controls are to be based upon each RMLO's assessment of the unique money-laundering, fraud, and terrorism risks associated with its products and services, as well as its size, geographic market(s), and other issues. FinCEN has emphasized that mortgage fraud is a significant operational risk facing RMLOs in the ordinary course of business, and that fraud prevention, as well as money laundering prevention, is a key goal underlying an effective AML program for an RMLO. The policies and procedures adopted must integrate any non-employee agents and brokers in its AML program and in obtaining required customer-related information.

The compliance officer to be appointed is responsible for implementation and monitoring of the ongoing effectiveness of the AML program, including by non-employee agents and brokers. The officer is also responsible for updating the AML program as needed, for example, as a result of changes in FinCEN regulations or in the risk profile of the RMLO. Also in the compliance officer's remit is ensuring that staff, agents and brokers are appropriately trained on an ongoing basis regarding the AML program.

Training of employees, agents and brokers regarding the AML program must be conducted periodically, and is intended to ensure their awareness and compliance with those policies implicated in their respective roles and the products and services with which they are involved. Training may be conducted directly by the RMLO, or by contracting with qualified third parties.

Independent testing of the adequacy of the AML program is required periodically, with the scope and frequency of testing commensurate with the risks posed by the products and services of the RMLO. While some companies use their external auditors for such testing, the regulations do not require this. The tests can be performed by an officer or employee of the RMLO, other than the designated compliance officer.

Suspicious Activity Reports

Under the new regulations, RMLOs will be required to file suspicious activity reports ("SAR") with FinCEN in certain circumstances, beginning August 13, 2012. In general, those circumstances are as follows.

SARs are required for transactions involving or aggregating at least \$5,000 conducted or attempted at a RMLO if the RMLO knows, suspects, or has reason to suspect, that the transaction meets one of the following four criteria: (i) it involves funds derived from illegal activity or is intended to hide or disguise funds derived from illegal activity; (ii) it is designed to evade any requirement of the BSA; (iii) it has no business or apparent lawful purpose or is not of a type in which the particular customer would reasonably be expected to engage and the RMLO knows of no reasonable explanation; or (iv) it involves the use of the RMLO to facilitate criminal activity. The last category would include transactions involving fraud or in which legally-derived funds are used for criminal activity.

SARs are filed directly with FinCEN, usually within 30 calendar days of detection by the RMLO of facts giving rise to a duty to file. A copy of each filed SAR, and the original (or business record equivalent) of its supporting documentation, must be retained by the RMLO for five years after filing of the SAR.

RMLOs, like other SAR filers, are generally prohibited from disclosing an SAR, or any information that would reveal the existence of an SAR. Under the BSA and the FinCEN regulations, RMLOs are shielded from liability for disclosures made to FinCEN in SAR filings, and for failure to notify any person identified in the SAR of its filing.

The delay in effectiveness of the SAR filing requirement for RMLOs, until August 13, 2012, has been granted in part to permit FinCEN to finalize its new, Internet-based SAR filing system, which will eliminate filing of paper SARs. On February 24, FinCEN announced that electronic filing of SARs generally will become mandatory on July 1, 2012. RMLOs will accordingly want to design their compliance procedures to accommodate FinCEN's electronic SAR filing system.

Enforcement

A failure by a RMLO to comply with the new regulations may constitute a violation of the BSA, exposing it to civil and criminal penalties, the severity of which depends on the specific circumstances. Currently, overall compliance with the FinCEN regulations by an RMLO that is not subject to oversight by another Federal regulator would be assessed by the Internal Revenue Service. FinCEN is consulting, however, with other Federal agencies (including the new Consumer Financial Protection Bureau), regarding a possible transfer of that administrative enforcement function.

Conclusion

FinCEN's application of the anti-money laundering and suspicious activity report requirements of the BSA to non-bank residential mortgage lenders and originators confronts those companies with a significant compliance challenge during the next six months. Among other things, the challenge includes potential operational changes, creation of a risk-based AML program (including policies, procedures and internal controls) reflecting the RMLO's own circumstances and risk exposures, appointment of a responsible compliance officer, conducting AML and SAR training for both staff and outside agents and brokers, and arranging for independent compliance reviews. To complete those requirements in a timely fashion, senior management supervision and attention will be advisable.

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