

**DEPARTMENT OF THE TREASURY**

**31 CFR Part 103**

RIN: 1506-AB02

**Financial Crimes Enforcement Network: Anti-Money Laundering Program and Suspicious Activity Report Requirements for Non-Bank Residential Mortgage Lenders and Originators**

**AGENCY:** Financial Crimes Enforcement Network (FinCEN), Department of the Treasury

**ACTION:** Advance notice of proposed rulemaking.

**SUMMARY:** FinCEN is issuing this advance notice of proposed rulemaking (ANPRM) to solicit public comment on a wide range of questions pertaining to the possible application of anti-money laundering (AML) program and suspicious activity report (SAR) regulations to a specific sub-set of loan and finance companies: non-bank residential mortgage lenders and originators. FinCEN seeks comment on: (1) an incremental approach to the issuance of regulations for loan and finance companies that would initially affect only those persons engaged in non-bank residential mortgage lending or origination; (2) how any such regulations should define persons engaged in non-bank residential mortgage lending or origination; (3) the financial crime and money laundering risks posed by such persons; (4) how AML programs for such persons should be structured; (5) whether such persons should be covered by BSA requirements other than the AML program requirement, including SAR reporting; and (6) whether any such persons should be exempted from AML program or SAR reporting requirements.

**DATES:** Written comments on this ANPRM must be received on or before [INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:**

FinCEN: You may submit comments, identified by Regulatory Identification Number (RIN) 1506-AB02, by any of the following methods:

- Federal E-rulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments. Include 1506-AB02 in the submission. Refer to Docket Number TREAS-FinCen-2009-0002.
- Mail: FinCEN, P.O. Box 39, Vienna, VA 22183. Include 1506-AB02 in the body of the text.

Please submit comments by one method only. All comments submitted in response to this ANPRM will become a matter of public record. Therefore, you should submit only information that you wish to make publicly available.

Inspection of comments: Comments may be inspected, between 10 a.m. and 4 p.m., in the FinCEN reading room in Vienna, VA. Persons wishing to inspect the comments submitted must request an appointment with the Disclosure Officer by telephoning (703) 905-5034 (not a toll free call). In general, FinCEN will make all comments publicly available by posting them on <http://www.regulations.gov>.

**FOR FURTHER INFORMATION CONTACT:**

FinCEN: Regulatory Policy and Programs Division, Financial Crimes Enforcement Network, (800) 949-2732 and select option 6.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

The Bank Secrecy Act (BSA)<sup>1</sup> authorizes the Secretary of the Treasury (the Secretary) to issue regulations requiring financial institutions to keep records and file reports that the Secretary determines “have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.”<sup>2</sup> The authority of the Secretary to administer the BSA has been delegated to the Director of FinCEN.<sup>3</sup>

Financial institutions are required to establish AML programs that include, at a minimum: (1) the development of internal policies, procedures, and controls; (2) the designation of a compliance officer; (3) an ongoing employee training program; and (4) an independent audit function to test programs.<sup>4</sup> When prescribing minimum standards for AML programs, FinCEN must “consider the extent to which the requirements imposed under [the AML program requirement] are commensurate with the size, location, and activities of the financial institutions to which such regulations apply.”<sup>5</sup> Federally regulated depository institutions are already required to have AML programs.<sup>6</sup> This ANPRM considers imposing on companies performing certain services with respect

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<sup>1</sup> “Bank Secrecy Act” is the name that has come to be applied to the Currency and Foreign Transactions Reporting Act (Titles I and II of Pub. L. 91-508), its amendments, and the other statutes referring to the subject matter of that Act. These statutes are codified at 12 U.S.C. § 1829b, 12 U.S.C. §§ 1951-1959, 18 U.S.C. § 1956, 18 U.S.C. § 1957, 18 U.S.C. § 1960, and 31 U.S.C. §§ 5311-5314 and 5316-5332, and notes thereto.

<sup>2</sup> 31 U.S.C. § 5311.

<sup>3</sup> See Treasury Order 180-01 (Sept. 26, 2002).

<sup>4</sup> 31 U.S.C. § 5318(h).

<sup>5</sup> Pub. L. 107-56 § 352(c), 115 Stat. § 322, codified at 31 U.S.C. § 5318 note. Pub. L. 107-56 is the USA PATRIOT Act of 2001.

<sup>6</sup> See 31 CFR 103.120.

to residential mortgages, analogous requirements to those currently applicable to depository institutions performing those same services.

The BSA defines the term “financial institution” to include, in part, “loan or finance company” and “persons involved in real estate closings and settlements.”<sup>7</sup> On April 29, 2002, and again on November 6, 2002, FinCEN temporarily exempted both of these categories of financial institutions, among others, from the requirement to establish an AML program.<sup>8</sup> The purpose of the temporary exemption was to enable Treasury and FinCEN to study the exempted categories of institutions and to consider the extent to which AML requirements should be applied to them, taking into account their specific characteristics and money laundering vulnerabilities.

On April 10, 2003, FinCEN issued an ANPRM regarding AML requirements for persons involved in real estate closings and settlements.<sup>9</sup> The 2003 ANPRM noted that the BSA had no definition of the term “persons involved in real estate closings and settlements;” that FinCEN had not had occasion to define the term in a regulation; and that the legislative history of the term provided no insight into how Congress intended the term to be defined. The 2003 ANPRM also noted that real estate transactions could involve multiple persons, including: real estate agents, banks, mortgage banks, mortgage brokers, title insurance companies, appraisers, escrow agents, settlement attorneys or agents, property inspectors and other persons directly and tangentially involved in property financing, acquisition, settlement, and occupation. The 2003 ANPRM further noted that the persons involved in real estate transactions, and the nature of their

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<sup>7</sup> 31 U.S.C. § 5312(a)(2)(P), (U).

<sup>8</sup> See 31 CFR 103.170; 67 FR 21113 (Apr. 29, 2002), as amended at 67 FR 67549 (Nov. 6, 2002) and corrected at 67 FR 68935 (Nov. 14, 2002).

<sup>9</sup> See 68 FR 17569 (Apr. 10, 2003).

involvement, could vary with the contemplated use of the real estate, the nature of the rights to be acquired, or how these rights were to be held, *e.g.*, for residential, commercial, portfolio investment, or development purposes. Finally, the 2003 ANPRM expressed FinCEN's views as to guiding principles that should be considered in defining persons involved in real estate closings and settlements. Any definitions or terms that define the scope of the rule should consider: (1) those persons (*i.e.*, individuals and business entities) whose services rendered or products offered in connection with a real estate closing or settlement can be abused by money launderers; (2) those persons who are positioned to identify the purpose and nature of the transaction; (3) the importance of various participants to successful completion of the transaction, which may suggest that they are well positioned to identify suspicious conduct; (4) the degree to which professionals may have very different roles, in different transactions, that may result in greater exposure to money laundering; and (5) involvement with the actual flow of funds used in the transaction.<sup>10</sup>

FinCEN has not issued any additional notices regarding persons involved in real estate closings and settlements since the 2003 ANPRM. This is FinCEN's first notice regarding loan and finance companies. FinCEN has in the interim continued its research and analysis related to the categories of financial institutions exempted in 2002.

In view of increasing concern among regulators, law enforcement and Congress over abusive and fraudulent sales and financing practices in both the primary and secondary residential mortgage markets, FinCEN also has undertaken a number of strategic, outreach and law enforcement support initiatives focused on residential mortgage lending.

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<sup>10</sup> See 68 FR 17569, 17570 (Apr. 10, 2003).

FinCEN is contemplating an incremental approach to implementation of AML regulations for loan and finance companies that would focus first on those business entities that are engaged in residential mortgage lending or origination and are not currently subject to any AML program requirement under the BSA or other federal law. These “non-bank residential mortgage lenders and originators” are primary providers of mortgage finance – in most cases dealing directly with the consumer - and are in a unique position to assess and identify money laundering risks and fraud while directly assisting consumers with their financial needs and protecting them from the abuses of financial crime. FinCEN believes that new regulations requiring non-bank residential mortgage lenders and originators to adopt AML programs and report suspicious transactions would augment FinCEN’s initiatives in this area. Among other benefits, such regulations would complement efforts underway by mortgage companies to comply with the nationwide licensing system and registry under development since the passage of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act).<sup>11</sup> As mortgage companies implement systems and procedures to comply with the S.A.F.E. Act, there will be opportunities for them to review and enhance their educational and training programs to ensure that employees are able to identify and appropriately deal with fraud, money laundering and other financial crimes.

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<sup>11</sup> See Title V of Division A of the Housing and Economic Recovery Act of 2008, Pub. L. No: 110-289, 122 Stat. 2810 (2008), codified at 12 U.S.C. §§ 5101, et. seq.

## II. Issues for Comment

This ANPRM solicits comment on all aspects of the potential impact of applying BSA requirements to non-bank residential mortgage lenders and originators.

### 1. *What are the money laundering risks in the non-bank residential mortgage finance sector?*

As noted in the 2003 ANPRM, the residential real estate sector may be vulnerable at all stages of the money laundering process. Money laundering is a process by which funds with an illicit origin are converted into funds with a plausibly legitimate origin. There are three general stages of money laundering. The “placement” stage is the stage at which funds from illegal activity or funds intended to support illegal activity are first introduced into the financial system. Money laundering “layering” involves the distancing of illegal funds from their criminal source through the creation of complex layers of financial transactions. “Integration” occurs when illegal funds are made to appear to have been derived from a legitimate source. Despite the relative illiquidity of most real estate assets, money launderers have used residential mortgage transactions - fraudulently and legitimately structured - to disguise the proceeds of crime.

In recent years, a significant percentage of SARs filed with FinCEN have reported suspected fraud-for-profit and fraud-for-housing schemes involving real estate brokers, appraisers, and other persons associated with real estate finance and settlements.<sup>12</sup>

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<sup>12</sup> See *Filing Trends in Mortgage Loan Fraud*, Feb. 2009, [http://www.fincen.gov/news\\_room/nr/pdf/20090225a.pdf](http://www.fincen.gov/news_room/nr/pdf/20090225a.pdf); *Mortgage Loan Fraud: an Update of Trends Based upon Analysis of Suspicious Activity Reports*, Apr. 2008, [http://www.fincen.gov/news\\_room/rp/files/MortgageLoanFraudSARAssessment.pdf](http://www.fincen.gov/news_room/rp/files/MortgageLoanFraudSARAssessment.pdf); *Suspected Money Laundering in the Residential Real Estate Industry*, Apr. 2008, [http://www.fincen.gov/news\\_room/rp/files/MLR\\_Real\\_Estate\\_Industry\\_SAR\\_web.pdf](http://www.fincen.gov/news_room/rp/files/MLR_Real_Estate_Industry_SAR_web.pdf); *Money Laundering in the Commercial Real Estate Industry*, Dec. 2006, [http://www.fincen.gov/news\\_room/rp/reports/pdf/CREassessment.pdf](http://www.fincen.gov/news_room/rp/reports/pdf/CREassessment.pdf); *Mortgage Loan Fraud: An Industry Assessment Based Upon Suspicious Activity Report Analysis*, Nov. 2006, [http://www.fincen.gov/news\\_room/rp/reports/pdf/mortgage\\_fraud112006.pdf](http://www.fincen.gov/news_room/rp/reports/pdf/mortgage_fraud112006.pdf).

FinCEN studies also have shown the connection between persons involved in mortgage fraud and other suspected financial crimes.<sup>13</sup> The crime of money laundering is defined, in part, with respect to the proceeds of specific unlawful, “predicate” activities. Both mortgage fraud and the act of laundering mortgage fraud proceeds are crimes under federal and state laws, and both are destructive to consumers, individual businesses and the financial system as a whole.

FinCEN seeks comment on the experience of the residential real estate lending sector with money laundering and fraud schemes, the existence of any safeguards in the industry to guard against these crimes, the impact that compliance with AML program and SAR reporting requirements may have on business operations, and what additional steps may be necessary to protect the industry from abuse by money launderers, including those who finance terrorist activity.

*2. Should FinCEN Pursue an Incremental Approach to Regulation of Loan and Finance Companies That Focuses First on Persons Engaged in Non-Bank Residential Mortgage Lending or Origination?*

As is the case with the term “persons involved in real estate closings and settlements,” the term “loan or finance company” is not defined or discussed in any FinCEN regulation, and there is no legislative history on the term. The term, however, could conceivably extend to any business entity that makes loans or finances purchases to or on behalf of consumers and businesses. For consumers, loan and finance companies originate loans and leases to finance the purchase of consumer goods such as automobiles, furniture, and household appliances. They also extend personal loans and loans secured by real estate mortgages, including home equity loans. For businesses,

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<sup>13</sup> See *Mortgage Loan Fraud Connections with Other Financial Crime: An Evaluation of Suspicious Activity Reports Filed by Money Services Businesses, Securities and Futures Firms, Insurance Companies and Casinos*, Mar. 2009, [http://www.fincen.gov/news\\_room/tp/files/mortgage\\_fraud.pdf](http://www.fincen.gov/news_room/tp/files/mortgage_fraud.pdf).

they supply short- and intermediate-term credit for such purposes as the purchase of equipment and motor vehicles and the financing of inventories. In addition, specialized wholesale loan and finance companies provide liquidity that allows retail loan and finance companies, as well as banks and others, to service end users.<sup>14</sup>

There has been a “regulatory gap” between the BSA’s coverage of depository institutions and non-bank residential mortgage lenders and originators. FinCEN is concerned that this disparity in BSA regulatory coverage may have made non-bank residential mortgage lenders and originators more vulnerable to financial crime and money laundering than their bank counterparts. FinCEN believes that implementation of appropriate, risk-based AML programs by non-bank residential mortgage lenders and originators will strengthen their existing compliance and anti-fraud programs, as well as the training and licensing programs that will be updated to comply with the S.A.F.E. Act. Moreover, a SAR reporting regulation likely would reduce the vulnerability of this sector and substantially expand FinCEN’s BSA database, thereby giving our regulatory and law enforcement partners a more complete macro and micro (case-specific) picture of mortgage-related financial crimes. In these and other respects, non-bank residential mortgage lenders and originators may assume an increasingly crucial role in government and industry efforts to protect consumers, mortgage finance businesses, and the United States financial system from money laundering and other financial crimes.

FinCEN is inclined to defer regulations for commercial real estate finance businesses and other types of consumer and commercial finance businesses until further

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<sup>14</sup> The North American Industry Classification System classifies approximately 10 types of mortgage finance-related businesses and professions and over 60 other businesses, professions and institutions (*e.g.*, consumer and commercial finance companies, pawnshops, auto finance, equipment leasing, personal credit companies, industrial loan companies and government sponsored enterprises) as primarily engaged in consumer and commercial lending and finance.

research and analysis can be conducted to enhance our understanding of their business operations and money laundering vulnerabilities.

FinCEN seeks general comment on whether FinCEN should adopt this incremental approach or some other approach to implementation of AML program and SAR regulations for loan and finance companies.

*3. How Should Persons Engaged in Non-Bank Residential Mortgage Lending or Origination Be Defined?*

Most real estate finance - both residential and commercial - involves complex transactions and multiple parties whose roles are not always readily discernable by the titles and terms used to describe them in generally accepted business practices or under applicable licensing and registration regimes. The primary mortgage market in the United States is very fragmented, and even simple real estate finance transactions may involve one or more parties that may originate, fund, broker, purchase, transfer, service, securitize, and insure the mortgage loan.

FinCEN believes that the views, assumptions and guiding principles noted in the 2003 ANPRM are equally relevant to the development of AML program and SAR reporting regulations for non-bank residential mortgage lenders and originators. AML obligations should focus on those persons (*i.e.*, individuals and business entities) that conduct the activities that place them in the best position to identify the nature of the transaction, recognize suspicious activity and prevent misuse of their services for money laundering and other financial crimes. This activities-based approach focuses on the nature of the activity conducted and its primary function in a particular residential mortgage transaction, rather than on the name or title of the person. Moreover, FinCEN believes that any regulations for non-bank residential mortgage lenders and originators

should strive to avoid, to the greatest extent possible, requirements that overlap or duplicate those of other BSA rules.

FinCEN seeks comment on which participants involved in non-bank residential mortgage finance are in a position where they can effectively identify and guard against financial crime and money laundering in the transactions they conduct. Information and comment may, among other things, address both the extent to which various participants have access to information regarding the nature and purpose of the transactions at issue and the importance of the participants' involvement to successful completion of the transactions. Comments are welcome from those involved centrally in the residential mortgage finance process (*i.e.*, those who may act as an agent for some or all of the parties and are responsible for reviewing the form and type of payment, as well as being aware of the parties to the mortgage transaction), and those who view their involvement as more peripheral.

Various definitions in the S.A.F.E. Act may be a useful reference for comments related to the development of regulatory definitions that would affect the scope of any proposed regulations for non-bank residential mortgage lenders and originators. FinCEN seeks comment specifically on whether FinCEN should adopt a definition of “non-bank mortgage lender or originator” that would be similar to the definition of “loan originator” in the S.A.F.E. Act.<sup>15</sup> The term “loan originator” in the S.A.F.E. Act means individuals who take applications for residential mortgage loan transactions, including employees of mortgage bankers and brokers, as well as loan officers of banks and their subsidiaries. The S.A.F.E. Act also provides a broad definition of “residential mortgage loan” that may be a useful reference for comments: “any loan primarily for personal, family, or

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<sup>15</sup> 12 U.S.C. § 5102(3).

household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act) or residential real estate upon which is constructed or intended to be constructed a dwelling . . . .”<sup>16</sup> As noted, the focus of this ANPRM is non-bank residential mortgage lenders and originators who are primary providers of mortgage finance and are in the best position to prevent and detect money laundering, fraud and other financial crimes. FinCEN seeks comment on whether any regulations promulgated by FinCEN should cover the same persons as those covered by the S.A.F.E. Act, or a broader or narrower range of persons.

*4. How Should the Anti-Money Laundering Requirements for Persons Engaged in Non-Bank Residential Mortgage Lending or Origination Be Structured?*

In applying the BSA to persons engaged in non-bank residential mortgage lending and origination, FinCEN must consider the extent to which the standards for AML programs are commensurate with the size, location, and activities of such persons. FinCEN recognizes that while large businesses are engaged in mortgage finance, businesses in this industry also include smaller companies or sole proprietors. FinCEN thus seeks comment on any particular concerns smaller businesses may have regarding the implementation of an AML program.

FinCEN believes that AML programs will complement the anti-fraud and general compliance programs that non-bank residential mortgage lenders and originators have established to comply with other federal and state laws and protect their own business operations. Many non-bank residential mortgage lenders and originators may be able to integrate risk-based AML reporting programs into existing enterprise-wide anti-fraud and

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<sup>16</sup> 12 U.S.C. § 5102(8).

compliance programs in a symbiotic manner that utilizes economies of scale and enhances the effectiveness of a business's compliance measures. FinCEN therefore seeks comment on what types of programs and practices that persons engaged in non-bank residential mortgage lending or origination have in place to prevent mortgage fraud and other illegal activities, and the applicability of such programs to the development of AML programs.

*5. Should FinCEN Require Persons Engaged in Non-Bank Residential Mortgage Lending or Origination to File SARs or Comply With Any Other BSA Requirements?*

As FinCEN emphasized in its recent report on mortgage loan fraud trends, SARs provide a valuable tool for regulatory agencies and law enforcement seeking to isolate specific instances of potential criminal activity for further investigation, and to identify emerging money laundering and terrorism financing trends.<sup>17</sup> The due diligence necessary for financial institutions to detect and report known or suspected suspicious activity greatly reduces vulnerability to the abuses of money laundering and terrorist financing.

FinCEN has promulgated SAR reporting regulations for a number of financial institutions that have AML program requirements, including mutual funds, insurance companies, futures commission merchants and introducing brokers in commodities, banks, brokers or dealers in securities, money services businesses, and casinos.<sup>18</sup>

FinCEN anticipates that any SAR regulation proposal applicable to persons engaged in non-bank residential mortgage lending or origination would have similar reporting

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<sup>17</sup> *Filing Trends in Mortgage Loan Fraud*, Feb. 2009, page 1, [http://www.fincen.gov/news\\_room/nr/pdf/20090225a.pdf](http://www.fincen.gov/news_room/nr/pdf/20090225a.pdf).

<sup>18</sup> See 31 CFR 103.15 – 103.21.

standards, thresholds and procedures as those set forth in SAR regulations for other industries.

In addition to any proposed SAR reporting regulations for non-bank residential mortgage lenders or originators, FinCEN also may propose to require these businesses to file currency transaction reports (rather than Form 8300) or retain certain records, including those related to large transmittals of funds.<sup>19</sup> These changes could be accomplished through amendments to the definitions regulation, 31 CFR 103.11 (specifically, to the definition of “financial institution”), and the exemptions regulation, 31 CFR 103.170 (specifically, to the temporary exemption from the AML program requirement); or they could be accomplished by issuing new regulations. FinCEN also recognizes that persons engaged in residential mortgage lending or origination may already have programs and practices in place to meet existing legal obligations or protect the business from fraud and other illegal activities. FinCEN requests comment on any aspect of possible new regulatory requirements, including any factors FinCEN should consider in structuring new requirements, exceptions, and differences from established regulations. Useful information would include any available estimates of volumes of transactions that might be subject to particular reporting or recordkeeping requirements.

*6. Should Any Persons or Transactions Be Exempted From Coverage of AML or SAR Regulations?*

FinCEN also solicits comment regarding whether there should be regulatory exemptions for any category of persons engaged in non-bank residential mortgage lending or origination, or any category of transactions conducted by such persons. Comments regarding possible exemptions should be designed to enable FinCEN to

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<sup>19</sup> See 31 CFR 103.22, 103.30 and 103.33.

evaluate whether the risk of money laundering through a category of persons or transactions is sufficiently small that a proposed rule could be crafted that would exempt the categories, while also providing adequate protection for the industry from the risks of money laundering. The question of exemption is specifically directed to professionals and those persons who are primarily engaged in a business related to residential mortgage lending or origination.

### **III. Conclusion**

With this ANPRM, FinCEN is seeking input on how FinCEN should implement the requirements of the BSA with respect to non-bank residential mortgage lenders and originators. We also seek input on: (1) estimates and financial projections on the likely costs of complying with AML program and SAR reporting regulations by specific types of non-bank residential mortgage lenders and originators; (2) the impact of any such regulatory requirements on industry profitability, growth and business practices; (3) the impact of these requirements on consumers seeking to obtain residential mortgages; (4) the effectiveness of examining for and enforcing compliance with these requirements; and (5) the advisability of establishing some minimum transaction threshold value or annual volume threshold below which some or all of these requirements would not apply. We also solicit comment on the impact to law enforcement and regulatory agencies. FinCEN welcomes comments on all aspects of the ANPRM, and we encourage all interested parties to provide their views.

**IV. Executive Order 12866**

This advance notice of proposed rulemaking is not a significant regulatory action under Executive Order 12866. Therefore, a Regulatory Assessment is not required.

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Acting Director  
Financial Crimes Enforcement Network