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HEADNOTE: MORTGAGE FORECLOSURES

Steven A. Meyerowitz 193

**THE MASSACHUSETTS SUPREME JUDICIAL COURT FORE-
CLOSURE DECISIONS: THE IMPACT ON THE SECURITIZATION
DOCUMENTATION PROCESS**

Stephen S. Kudenholdt, Stephen F.J. Ornstein, and John P. Holahan 195

**D&O INSURANCE: AVOIDING TRAPS AND KEEPING
COVERAGE IN A DISTRESSED BANKING ENVIRONMENT**

Robert P. Sieland and Craig E. Goesel 206

**CAN LENDERS PREVENT LLC BANKRUPTCY FILINGS?
A RECENT DECISION HIGHLIGHTS THE DEBATE**

Sheldon L. Solow and Uday Gorrepati 220

**FINCEN PUBLISHES FINAL RULE AND INTERPRETIVE
GUIDANCE CLARIFYING THE SCOPE OF SAR'S
CONFIDENTIALITY PROVISIONS**

Jeffrey M. Telep and Jane Y. Cohen 227

**FINCEN PROPOSES RULE REQUIRING NON-BANK RESIDENTIAL
MORTGAGE LENDERS AND ORIGINATORS TO ESTABLISH AML
PROGRAMS AND FILE SARs**

Andrew B. Kales and Christian G. Wilson 232

**TRUSTEE ASSET MANAGEMENT ELECTIONS: PORTFOLIO
PERFORMANCE EVALUATION AND PREFERENCING
CRITERIA: PART TWO**

Patrick J. Collins 237

BANKING BRIEFS

Donald R. Cassling 285

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FINCEN PROPOSES RULE REQUIRING NON-BANK RESIDENTIAL MORTGAGE LENDERS AND ORIGINATORS TO ESTABLISH AML PROGRAMS AND FILE SARs

ANDREW B. KALES AND CHRISTIAN G. WILSON

The authors examine a proposed rule issued recently by FinCEN that would subject non-bank residential mortgage lenders and originators to the anti-money laundering and suspicious activity reporting requirements of the Bank Secrecy Act.

The Financial Crimes Enforcement Network (“FinCEN”) has issued a proposed rule that would subject non-bank residential mortgage lenders and originators to the anti-money laundering and suspicious activity reporting requirements of the Bank Secrecy Act. FinCEN issued the proposal to close a “regulatory gap” that FinCEN believes exists between the Bank Secrecy Act’s coverage of depository institutions and residential mortgage lenders and originators that prevents regulatory and law enforcement partners from obtaining a “more complete picture” of mortgage-related financial crimes.

The proposal is part of a larger, incremental effort by FinCEN to implement anti-money laundering (“AML”) and suspicious activity report (“SAR”)

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regulations for non-bank loan and finance companies. FinCEN views residential mortgage lenders and originators—the primary providers of mortgages to consumers—as being in a “unique position to assess and identify” AML risks and fraud in the mortgage industry. FinCEN believes that the proposal, taken together with the nationwide licensing system and registry currently under development as a result of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, will help ensure that residential mortgage lenders and originators properly identify and address money laundering, fraudulent activity, and other financial crimes.

The proposal is based in large part on the advance notice of proposed rulemaking, published by FinCEN in July 2009, and related comments.

RESIDENTIAL MORTGAGE LENDERS AND ORIGINATORS SUBJECT TO THE PROPOSAL

The Bank Secrecy Act defines the term “financial institution” to include, in part, “a loan or finance company.” Banks or other functionally regulated financial institutions, which are already subject to AML program and SAR reporting requirements are not loan and finance companies, but FinCEN recognizes that the term could conceivably extend to any other business entity that makes loans to, or finances purchases on behalf of, consumers and businesses.

The proposal would apply only to loan or finance companies which are either “residential mortgage lenders” or “residential mortgage originators,” although future rulemakings may cover other types of loan or finance companies.

- A “residential mortgage lender” would be defined as “[t]he person to whom debt arising from a residential mortgage loan is initially payable on the face of the evidence of indebtedness or, if there is no such evidence of indebtedness, by agreement, or to whom the obligation is initially assigned at or immediately after settlement.”
- A “residential mortgage originator” would be defined as “[a] person that takes a residential mortgage loan application and offers or negotiates terms of a residential mortgage loan for compensation or gain.”

In both of these definitions, a key term is “residential mortgage loan.”

Such a loan would be any loan “that is secured by a mortgage, deed of trust, or other equivalent consensual security interest” on a one-to-four family residential structure or real estate on which a residential structure will be built. FinCEN explained that this definition is intended to encompass any loan secured by residential real property, regardless of whether the borrower is purchasing the residential real property as a primary residence, vacation home, or investment, is refinancing a purchase-money mortgage loan to obtain a more favorable rate and/or terms, or is obtaining a mortgage loan for another purpose, such as debt consolidation or mobilization of home equity.

The definition of “residential mortgage lender” would specifically exclude an individual who finances the sale of his or her own dwelling or real property. In addition, the definitions of “residential mortgage lender” and “residential mortgage originator” would not cover persons who are solely responsible for administrative functions that support or facilitate residential mortgage finance transactions.

AML PROGRAM REQUIREMENT

Under the proposal, residential mortgage lenders and originators would be required to establish risk-based AML programs designed to prevent the facilitation of money laundering and terrorist financing. The AML program must be in writing, approved by senior management, designed to ensure compliance with the Bank Secrecy Act, and made available to FinCEN upon request.

At a minimum, similar to other financial institutions subject to AML program requirements, the AML program of each residential mortgage lender or originator would need to include the following elements:

- Policies, procedures, and internal controls based on the residential mortgage lender’s or originator’s assessment of the money laundering and terrorist financing risks associated with its products, customers, distribution channels, and regimes. The policies and procedures should also include provisions for complying with the Bank Secrecy Act and FinCEN’s regulations; integrating agents and brokers; and obtaining all relevant customer-related information necessary for an effective AML program.
- Designation of an AML compliance officer responsible for administering

the AML program.

- Ongoing training of appropriate personnel concerning their responsibilities under the AML program.
- Independent testing of the AML program on a periodic basis to ensure that it complies with the requirements of the rule and that the program functions as designed, including testing to determine compliance of agents and brokers with their compliance obligations under the program.

FinCEN would be responsible for examining residential mortgage lenders and originators for compliance with the AML program requirement.

SAR REQUIREMENT

The proposal would require residential mortgage lenders and originators to report suspicious transactions that are conducted by, at, or through the residential mortgage lender or originator which involve or aggregate to at least \$5,000 in funds or other assets. As with other categories of financial institutions, the types of activity that would trigger the obligation to submit a SAR would include knowledge or suspicion of a transaction that:

- involves funds that are derived from or are intended to obscure illegal activity;
- is designed to evade Bank Secrecy Act requirements;
- has no business or apparent lawful purpose and there exists no reasonable explanation for the transaction after due examination; or
- involves the use of residential mortgage lenders or originators to facilitate criminal activity.

The SAR would need to be filed within 30 days after the residential mortgage lender or originator becomes aware of a suspicious transaction. The obligation to identify and report a suspicious transaction would rest with the residential mortgage lender or originator involved in the transaction, but multiple entities involved in the same transaction would be permitted to file

joint SARs.

A residential mortgage lender or originator which files a SAR would be required to maintain copies of the SAR and underlying related documentation for five years from the date of filing. Supporting documentation would need to be made available to FinCEN and law enforcement and regulatory authorities, upon request.

As with other financial institutions subject to SAR reporting requirements, residential mortgage lenders and originators would be obligated to keep SARs confidential. A SAR and any information that would reveal the existence of a SAR must be kept confidential and may not be disclosed except under certain circumstances authorized by the proposal, such as disclosure to FinCEN, local law enforcement, or regulatory authorities.

COMPLIANCE DATE

Under the proposal, a residential mortgage lender or originator would be required to develop an AML program by the later of six months from the effective date of the final rule or six months after the date on which the residential mortgage lender or originator is established. The SAR reporting requirement would apply to transactions occurring after the date on which the residential mortgage lender or originator is required to establish its AML program.