



Anti-Money Laundering Requirements for Residential Mortgage Originators and Brokers: What You Need to Know Now

Frank A. Mayer, III, Audrey D. Wisotsky, Richard J. Zack, - March 29, 2012



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- Partner in the Princeton office of Pepper Hamilton LLP
- Concentrates her practice on regulatory issues and transactions related to mortgage banking, consumer finance and the secondary mortgage market
- Representation of financial services clients includes regulatory, compliance and licensing issues; secondary mortgage market transactions, including the sale and purchase of mortgage loan portfolios, servicing agreements and various aspects of the securitization of mortgage loans; master servicing and sub-servicing agreements; and loan documentation, including state and federal disclosures.

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- Partner in the Financial Services Practice Group of Pepper Hamilton LLP, resident in the Philadelphia office
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- Prior to joining Pepper was chief of commercial and consumer fraud and deputy chief of economic crimes for the U.S. Attorney's Office for the Eastern District of Pennsylvania
- Has extensive experience in the investigation and prosecution of mortgage fraud and other financial crimes.

Financial Crimes Enforcement Network (FinCEN) issues Final Rule



- Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Residential Mortgage Lenders and Originators (February 2012)
- Final Rule includes non-bank residential mortgage lenders and originators
- Effective Date: April 16, 2012
- Compliance Date: August 13, 2012

The Bank Secrecy Act (BSA)



Context

- Requires all financial institutions to make anti-money laundering efforts, including:
 - Depository institutions, persons registered with and functionally regulated or examined by the SEC or Commodity Future Trading Commission
 - Instituting “Know Your Customer” (KYC) protocols
 - Maintaining certain records
 - Filing Currency Transaction Reports (CTRs) on transactions over \$10,000
 - Filing Suspicious Activity Reports (SARs) with respect to any transaction involving at least \$5,000 if the bank has reason to suspect that the transaction:
 - Involves funds derived from illegal activities
 - Was designed to evade BSA requirements
 - Has no business or apparent lawful purpose

The Proliferation of “Red Flags”

- The FFIEC’s Bank Secrecy Act/Anti-Money Laundering Examination Manual lists 11 pages of red flags.
- Recent civil litigation in which plaintiffs allege that banks have aided and abetted Ponzi schemes and other fraud identify additional red flags.



Enforcement Actions

- August, 2011 – FDIC and FinCEN fine Ocean Bank \$10.9 million for failure to institute adequate compliance program, including:
 - Failure to adequately test SAR function
 - Failure to adequately staff its BSA compliance department
- March, 2011 – OCC and FinCEN fine Pacific National Bank \$7 million for BSA violations, including delayed and incomplete SARs
- February, 2011 – OCC and FinCEN file Zions First National Bank \$8 million for failure to establish effective AML program with respect to its foreign correspondent banking relationships
- 2010 – DOJ fined Wachovia bank \$160 million for maintaining a deficient AML program that allowed Mexican gangs to launder hundreds of millions of dollars.

Bank Secrecy Act Filings, 2009-2011

Type of Form	2009	2010	2011
Currency Transaction Report (all types)	14,909,716	14,065,871	14,826,316
Suspicious Activity Report (for all covered industries)	1,321,848	1,319,984	1,446,273
Report of Foreign Bank and Financial Accounts	276,386	594,488	618,134
Registration of Money Services Business	19,234	20,302	20,315
Designation of Exempt Persons	32,117	22,990	18,616
Report of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300)	180,801	174,023	194,366
Total	16,740,102	16,197,658	17,124,020

- FinCEN 2011 Annual Report

Increasing Number of Civil Actions



- Cases stemming from Madoff and Stanford Ponzi schemes
 - Picard v. JP Morgan Chase & Co., S.D.N.Y. Bankr., No. 10-1p-0432; Picard v. JP Morgan Chase & Co., S.D.N.Y., No. 11-00913
 - MLSMK Investments Co. v. JP Morgan Chase & Co., S.D.N.Y., No. 09-4049
- Perlman v. Wells Fargo Bank, S.D. Fla., No. 10-81612

3 Elements of Aiding and Abetting Liability



- Existence of a Fraud
- Defendant's actual knowledge of the fraud
 - Variation among courts re whether knowledge of atypical banking activity is sufficient to establish element
- Defendant's substantial assistance to advance the fraud's commission
 - Many courts have held that absent a fiduciary duty, failure to act does not satisfy substantial assistance – no duty to non-depositors
 - Plaintiffs attempt to argue that the BSA and AML regulations and advisory publications set the standard of care
 - Disagreement re whether routine banking services can constitute substantial assistance

Capitaliza-T v. Wachovia, 2011 U.S. Dist. LEXIS 146599 (D. Del. 2011)



- Plaintiff sufficiently stated a claim against Wachovia for aiding and abetting Majapara, a Mexican currency exchange business, in committing fraud
- Substantial Assistance – sufficiently pled because Complaint alleged that Wachovia:
 - Satisfied all of Majapara’s financing needs
 - Concealed the origin, background, and nature of financial transactions
 - Imbued Majapara with an air of legitimacy
 - Consciously failed to disclose Majapara’s atypical transactions
 - Knew about the fraud committed on the Plaintiff and failed to disclose it

Capitaliza-T v. Wachovia, 2011 U.S. Dist. LEXIS 146599 (D. Del. 2011)



- Actual Knowledge – Sufficiently pled because Complaint alleges that Wachovia:
 - Knew that Majapara’s corporate purpose did not include handling deposits on behalf of third parties
 - Knew that Majapara was not licensed as a stock broker
 - Knew that the transaction involving Plaintiff’s funds exceeded the \$5,000 threshold for SARs
 - Was aware of numerous red flags
 - Was warned by FinCEN of the potential for fraud
 - Knew that the transaction involving Plaintiff’s funds was unrelated to any legitimate business purpose

Perlman v. Wells Fargo Bank, N.A.



- Grants in part and denies in part bank's motion to dismiss
- Aiding and Abetting Liability
 - Finds substantial assistance:
 - Theodore depended on a bank to effect the embezzlement
 - Relative ordinariness of a transaction has no bearing
 - Finds knowledge
 - Holds that atypical transactions allow the court to infer knowledge:
 - Notes that violations of the BSA are “not in themselves important” to the court's consideration

Amacker v. Renaissance Asset Mgmt. LLC, 657 F.3d 252 (5th Cir. 2011)



- Futures commission merchants did not violate the Commodity Exchange Act by aiding and abetting an investment pool operator's fraud.
- BSA violation (failure to conduct more than a cursory investigation into merchant's identity and registration status) does not satisfy Act's requirement that the merchant act "willfully."
- "If the evidence shows no more than transactions constituting the daily grist of the mill, [the court] would be loath to find [aiding and abetting] liability"

Applicability to Residential Mortgage Lenders and Originators



FinCEN Imposes Anti-Money Laundering Compliance and Suspicious Activity Reporting Requirements on Non-Bank Residential Mortgage Lenders and Originators

Non-bank Mortgage Lenders



“Today, FinCEN is closing a regulatory gap by requiring non-bank mortgage lenders and originators to develop anti-money laundering programs and file suspicious activity reports with FinCEN. Suspicious activity reports are a critical source of information to law enforcement and regulatory agencies in their investigation and prosecution of mortgage fraud and a wide range of other financial crimes.”

FinCEN Director James H. Freis Jr. on February 7, 2012

AML Policy Requirement



- Each loan or finance company shall develop and implement a written anti-money laundering program that is reasonably designed to prevent the loan or finance company from being used to facilitate money laundering or the financing of terrorist activities. The program must be approved by senior management. A loan or finance company shall make a copy of its anti-money laundering program available to the Financial Crimes Enforcement Network or its designee upon request.
 - 31 C.F.R. sec. 1029.210(a)

SAR Filing Requirement

- Every loan or finance company shall file with FinCEN, to the extent and in the manner required by this section, a report of any suspicious transaction relevant to a possible violation of law or regulation.
 - 31 C.F.R. sec. 1029.320(a)(1)

Who Is Covered?

- Definitions:
 - Residential Mortgage Lenders
 - The person to whom the debt arising from a residential mortgage loan is initially payable on the face of the evidence of indebtedness or ... to whom the obligation is initially assigned at or immediately after settlement.
 - Residential Mortgage Originators
 - A person who accepts a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan.

Are You Excluded?

- Individual financing the sale of their own real estate
- Person registered with or functionally regulated or examined by The Securities and Exchange Commission on The Commodity Futures Trading Commission or a government sponsored enterprise regulated by The Federal Housing Finance Agency.
- Federal or state agencies administering mortgage or housing assistance, fraud prevention or foreclosure prevention programs.

Overview

- The Final Rule appears to be intended to cover initial purchase money loans and traditional refinancing transactions facilitated by non-depository bank, independent mortgage lenders and originators.
- The covered nonbank is not considered a “financial institution” under FinCEN’s regulations. Therefore:
 - No responsibility for Currency Transaction Report filing or related record retention. Note however a covered nonbank mortgage lender remains subject to the FinCEN and IRS Form 8300 (revised Nov 2011) requirement involving receipt of more than \$10,000 in currency.

Regulatory Goal

- Requirement to develop and implement a risk-based AML program to prevent covered entity from being used to facilitate fraud, money laundering and financing of terrorist activities.
- Complements ongoing regulatory reform: SAFE ACT
- Complements law enforcement efforts:
 - HUD-OIG
 - Financial Fraud Enforcement Task Force
 - Mortgage Fraud Working Group
 - National Association of Attorneys General
 - National District Attorneys Association

Four Pillars

- According to James H. Fries, Jr., Director, Financial Crimes, Enforcement Network:
 - AML compliance rests on same “four pillars” of compliance that apply to all financial institutions under the BSA.
 1. Policies, Procedures and Internal Controls
 - “tone at the top”
 - integrate agents and brokers
 2. AML Compliance Officer
 3. On-going Training
 4. Independent Test
 - “Last line of defense”
 - targets weakness
 - risk based

Suspicious Activity Reporting

- Requirement mirrors that of other financial institutions
- Reportable within 30 days IF:
 - Involves funds derived from illegal activity or is intended to or structured or disguised of funds or assets derived of illegal activity as part of a plan to violate a law or regulation
 - Designed to evade BSA requirements
 - No business purpose or not type in which customer would normally be expected to engage [KYC?]
 - Involves use of lending operation to facilitate criminal activity

Confidentiality

- Disclosure only to FinCEN, federal, state or local law enforcement agencies and regulatory agencies.
- Attorney Advisors and confidentiality

Safe Harbor

- Protection from civil liability from 3rd party
- Mortgage Bankers Association's position
- FinCEN's position

Examination and Enforcement



- IRS has delegated authority to examine for BSA compliance
 - Staffing and resources
 - CFPB
 - State Regulators
 - Current comments and memoranda of understandings
- CFPB confidentiality issues
- Consistency in examination protocols across jurisdictions

Recent Enforcement Action

- Operation Stolen Dream
 - FinCEN analysis and many law enforcement investigations have revealed mortgage related fraud to be part of organized criminal activity involving multiple properties and various types of criminal activity. On June 17, 2010, Attorney General Eric Holder announced the results of a nationwide effort, Operation Stolen Dreams, which targeted mortgage fraud perpetrators throughout the country. The sweep, organized by the FFETF, was the largest collective enforcement effort to date in confronting mortgage fraud.

What Should You Do Now?

A. Risk Assessment

- Know your business!
- What are the riskiest aspects of your business?

B. Due Diligence

- Customer Due Diligence – KYC
- Review loan origination documents and procedures

C. Training

- How do your typical customers behave?
- Outlier?

D. Independently Test System

- Confidentiality and implications to examination and enforcement.
- Informal audit department
- Outsourcing - confidentiality



Questions and Answers

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