

Lenders Compliance Group

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Anti-Money Laundering-Red Flags and the SAR Narrative

Even though AML compliance for nonbanks has been in effect since August 13, 2012, many **Residential Mortgage Lenders and Originators** (RMLO) still seem to have considerable difficulty in two specific areas: how to determine when a **Suspicious Activity Report** (SAR) should be filed, and which suspicious activity events or features may trigger the SAR filing requirement.

In one article, entitled *Anti-Money Launder Debuts for Nonbanks*, I unpack the AML Program in a way that will provides some familiarity with the AML Compliance scope, while perhaps also making its implementation a bit less daunting than it might otherwise seem to be.

In another article, entitled *Anti-Money Laundering Program: Preparation is Protection*, I outlined many of the so-called Red Flags and other triggering events. In addition, I offered a way to construct a SAR narrative - the description to FinCEN about the alleged suspicious activity - that, based on years of experience auditing and implement AML compliance on behalf of our clients, best meets FinCEN's expectations of an informative statement.

To give you an idea of the size and complexity of a well-constructed AML Program, my firm's AML Program is well over fifty pages - which consists of a policy statement and numerous appendices for applicable procedures. This should give you some idea of the depth and detail needed for properly implementing AML compliance. The absence of or any inaccuracies in required program components may indicate a defective policy and procedures - the very tools needed to assist in detecting and preventing money laundering or other illegal activities conducted through mortgage banking conduits.

So, a **word of caution** is due: do not take the chance of buying an abbreviated or defective AML Program, in the hope of merely satisfying the "basic" FinCEN requirements. Obtaining a boilerplate document with your company's name on it is regressive, and it is a tactic that Examiners are now regularly criticizing in adverse findings.

These days, regulators are fully aware of this 'short cut' to compliance. An insufficient AML Program may cause adverse examination findings. Indeed, in some cases, template-driven policy and procedures may cause Examiners to escalate their regulatory review of an RMLO's anti-money laundering implementation.

AML compliance is a specialized area of mortgage compliance, necessitating genuine, practical, hands-on, regulatory compliance and experiential knowledge, and an AML Program must reflect precise policies and procedures that not only implement the SAR regulations but also conform to a company's way of doing business.

Therefore, an AML Program is one policy statement and set of procedures where the purchase price should not be an operative consideration. Caveat Emptor!

This is why I want to further outline the descriptive process of completing the SAR narrative, emphasizing a simple method I call **The 5 W's and the How**, and I will also provide details regarding both so-called Red Flags and triggering events. So, even if a company has a skimpy or defective AML policy and procedures, at least those who implement AML Compliance may be offered some rudimentary guidelines to consider in the practical experience of actually filing a SAR.

IN THIS ARTICLE

[The 5 W's and the How](#)

[Triggering Events](#)

[Documentation Red Flags](#)

[Applicant Red Flags](#)

[RMLO's Employee Red Flags](#)

[Library Resources](#)

The 5 W's and the How

If I were to choose the central feature of the SAR, I would select the SAR narrative.

Each SAR requires a narrative to be provided by the SAR filer.

Over time, my firm has compiled numerous examples of common patterns of suspicious activities from our audit and due diligence reviews. Based on our experience and FinCEN's

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own stated guidance, we believe that there are five interrogative categories to be considered when writing a SAR narrative: **who? what? when? where? and why?**

The method of operation (or how?) is also very important and should be included in the SAR narrative.

HERE ARE "THE 5 WS" TO THE SAR NARRATIVE:

1. **Who** is conducting the suspicious activity?
2. **What** instruments or mechanisms are being used to identify the suspicious activity?
3. **When** did the suspicious activity take place?
4. **Where** did the suspicious activity take place?
5. **Why** does the filer think the activity is suspicious?

FinCEN suggests that the RMLO describe briefly its industry or business (i.e., mortgage banker, mortgage broker). Then describe, as fully as possible, why the activity or transaction is unusual, considering the types of products and services that the mortgage industry or the RMLO offers, and the nature and normally expected, transactional activities of customers.

HERE IS THE "HOW" TO THE SAR NARRATIVE:

Always include the How! This is an important feature of a SAR narrative.

- **How** did the suspicious activity occur?

The narrative section of the SAR should describe the *modus operandi* or the method of operations of the subject conducting the suspicious activity. In a concise, accurate, and logical manner, the filer should provide a description of how the suspect transaction or pattern of transactions was committed. As completely as possible, the SAR narrative should offer a full picture of the suspicious activity.

At all costs, avoid long, rambling, and circuitous descriptions. When completing the narrative section of the SAR, many clients actually state the forgoing questions and then answer each question. Consequently, FinCEN is able to quickly understand the predicate conditions for filing the SAR.

Triggering Events

FinCEN has made it clear that certain triggering events constitute the appearance of mortgage loan fraud. Perpetrators seem to invent new scams all the time. Indeed, FinCEN continues to issue reports periodically about the most current methods to commit mortgage fraud.

Some salient schemes:

Occupancy Fraud

In order to obtain favorable loan terms, claiming that subject properties will be the primary residences instead of vacation homes or investment properties. Also: when applying for loans for properties that others (i.e., family members) will actually occupy.

Income Fraud

Overstating income to qualify for larger mortgages and understating income to qualify for hardship concessions and modifications.

Appraisal Fraud

Overstating home value to obtain more money from a sale of property or cash-out refinancing and understating home value in connection with a plan to purchase a property at a discount to market value.

Employment Fraud

Misrepresenting whether, where, and for how long the applicants have been employed, whether they are unemployed or collecting unemployment benefits, and whether they are independent contractors or business owners.

Liability Fraud

Failing to list significant financial liabilities on the loan application (i.e., other mortgages, car loans, or student loans).

Debt Elimination

Faking legal documents and alternative payment methods to argue that existing mortgage obligations are invalid or illegal, or to purport to extinguish mortgage balances. Individuals orchestrating debt elimination schemes typically charge borrowers a fee for these debt elimination "services".

Foreclosure Rescue Financially distressed homeowners are targeted with fraudulent offers of services or advice aimed at stopping or delaying the foreclosure process. Some of these scams require homeowners to transfer title - or make monthly mortgage payments - to the purported "rescuer," rather than the real holder of the mortgage. Some foreclosure rescue scams require homeowners to pay fees before receiving "services," and are known as "advance fee" schemes.

Social Security Number (SSN) and Identity Theft

An SSN or other government identification card or number that belongs to someone other than the applicant in a loan application is used by the perpetrator. Identity Theft includes broader use of another's identity or identifiers (beyond an SSN) to obtain a mortgage or perpetrate a "fraud for profit" scheme.

Home Equity Conversion Mortgage (HECM)

Financial institutions need be aware of illegal "reverse mortgage" schemes, which

unfortunately targets seniors who own a home or who are coerced into taking title to a home. The purpose of this scam is to steal or otherwise acquire some or all of the funds which senior receives from a government HECM program. This fraud has other nefarious features, such as appraisal fraud (i.e., increasing the stated value of the home), investment fraud to acquire the HECM funds from the senior under the guise of future profits for the senior, and identify theft to acquire HECM funds without the knowledge of the senior who owns the property.

Documentation Red Flags

In our AML policy and procedures, we have addenda for Red Flags. We continually add to them, as needed, because the inventiveness of the perpetrators seems endless. So any list provided herein cannot realistically be taken as comprehensive. Red Flags do not only pertain to the documentation process but also extend to the way a loan officer or even the applicant behaves. I know - the latter items seem highly subjective, and surely they are! Some inherent subjectivity may play a role in identifying mortgage fraud.

- Applicant submits invalid documents in order to cancel mortgage obligations or to pay off loan balances.
- Same notary public and/or other "authorized representative" prepares, signs, and sends packages of nearly identical debt elimination documents for multiple borrowers with outstanding mortgage balances.
- Same notary public and/or other "authorized representative" working with and/or receiving payments from unusually large numbers of borrowers.
- Falsification of certified checks, cashier's checks or "non-cash item checks" drawn against a borrower/buyer's account, rather than from the account of a financial institution.
- Applicant applies for a loan for a "primary residence" but does not reside in the new primary residence as indicated on the loan application; that is, other individuals occupy the borrower's new primary residence, thereby indicating the property is being used as a secondary residence or income-generating property.
- Applicant of a younger age purchases his or her "primary residence" in a senior citizen residential development.
- Applicant requests refinancing for "primary residence" when public and personal documents indicate that the applicant resides somewhere other than the address on the loan application.
- Language included in a short sale contract indicates the property could be resold promptly. This possibly illegal "flipping" may occur regardless of whether the Federal Housing Administration (FHA) has re-enacted or waived its arms-length resale regulations to FHA buyers.
- Low appraisal values, non-arms length relationships between short sale buyers and sellers, or previous fraudulent sale attempts in short-sale transactions.
- Agent of the buyer and/or seller in mortgage transaction is unlicensed.
- Past misrepresentations made by applicant in attempts to secure funding, property, refinance, and/or shorts sales.
- Improper and/or incomplete file documentation, including borrower/buyer reluctance to provide more information and/or unfulfilled promises to provide more information.
- Apparent resubmission of a rejected loan application with key applicant details changed or modified.
- Applicant attempts to structure currency deposits and/or withdrawals, or otherwise to hide or disguise the true value of assets, in order to qualify for loan modification programs intended for those homeowners in financial distress.
- Request from third party affiliates on behalf of distressed homeowners to pay fees in advance of the homeowner receiving mortgage counseling, foreclosure avoidance, a loan modification, or other related services.
- Third party solicitation of distressed homeowners for purported mortgage counseling, foreclosure avoidance, loan modification, or other related services. These third parties may also claim to be associated with legitimate mortgage lenders, the U.S. government, or a U.S. government program.

Applicant Red Flags

The applicant:

- Appears nervous for no good reason.
- Avoids eye contact.
- Asks about reporting rules.
- Asks that rules be 'bent'.
- Questionable source of funds.
- 'Forgot' driver's license claim, lost due to drunk driving, had wallet (purse) stolen.
- Driver's license is outdated or picture is smudged beyond recognition.
- Address on driver's license is different from one on RMLO form.
- Comes in just before closing and asks for 'paper work' to be skipped.

comes in just before closing and asks for paper work to be shipped.

- Is impatient and tries to hurry.
- Offers a cash bonus (aka 'bribe') for to skip required information.
- Pretends to be sick or very tired and just 'wants to get the application over with.'
- Provides incomplete or suspicious information.
- Evinces an abnormal or irregular way of doing business or behaving.
- Claims the application is for a friend and does not have the required information.
- Lists funds that are inconsistent with applicant's financial or economic situation.
- Causes suspicion of attempting a straw buyer transaction.
- Elicits suspicion of structuring.
- Provides liquid funds information from an unusual or suspicious source.
- Provides apparently fraudulent documentation.

RMLO's Employee Red Flags

The RMLO's Employee:

- Never or almost never takes a vacation.
- Does not want supervisory personnel to see or be aware of transactions with an applicant.
- Behavior changes to secretive with certain applicants.
- Acts guilty. (Whatever that means!)
- Does not want supervisors to see forms filled out by an applicant.
- Whispers with certain applicants.
- Asks certain applicants to come back later when nobody is in the office.
- Lives beyond means.

The Applicant and RMLO's Employee Red Flags are obviously somewhat "intuitive" in that these are evoked feelings that something is amiss. None of these categories of Red Flags, just by themselves, constitute collusion with a perpetrator. Still, these types of indicia have appeared on SARs filed with FinCEN.

Summary

It is important to develop a reliable understanding about when an RMLO should be required to file a particular SAR. In my view, a determination as to whether a SAR is required must be based on all the facts and circumstances relating to the transaction and customer of the RMLO. Different fact patterns will require different judgments.

The techniques of money laundering and mortgage fraud are continually evolving, and there is no way to provide an exhaustive list of suspicious activity transactions. A strong AML Program should be sufficiently comprehensive in its understanding of the RMLO's organizational structure, business practices, products, services, affiliates, consumers, and vendors, to be able to monitor for suspicious activity that may involve fraud, money laundering, and other financial crimes, without becoming a burden to the effective and cost-efficient operations of all affected departments throughout the loan flow process.

Be sure to document SAR decisions, including the specific reason for filing or not filing a SAR. Thorough documentation provides a record of the SAR decision-making process, including final decisions not to file a SAR. However, due to the variety of systems used to identify, track, and report suspicious activity, as well as the fact that each suspicious activity reporting decision will be based on unique facts and circumstances, no single type of documentation is required when a company decides not to file.

The decision to file a SAR may indeed be viewed as an inherently subjective judgment. During banking examinations the Examiner will focus on whether the company has a comprehensive AML policy and set of procedures, and an effective SAR decision-making process, utilizing such tools as Red Flags, that will lead to a cogent SAR Narrative. Examiners may review individual SAR decisions as a means to test the effectiveness of the SAR monitoring, reporting, and decision-making process outlined in the AML Program.

Library



Anti-Money Laundering

Residential Mortgage Lenders and Originators



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