

BY FEDERAL E-RULEMAKING PORTAL

January 9, 2012

Financial Crimes Enforcement Network  
Department of the Treasury  
P.O. Box 39  
Vienna, Virginia 22183

**Re: Anti-Money Laundering Program and Suspicious Activity Reporting Requirements for Housing Government Sponsored Enterprises; RIN 1506—AB14**

Dear Sir or Madam:

On November 8, 2011, the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury, issued a proposed rule<sup>1</sup> (the Proposed Rule) which would subject the Federal Home Loan Banks (FHLBanks or Banks), Fannie Mae, and Freddie Mac to anti-money laundering program (AML) and suspicious activity reporting (SAR) requirements under the Bank Secrecy Act (BSA). This letter sets forth comments of the FHLBanks on the Proposed Rule. We thank you for the opportunity to be heard on this important matter.

**The FHLBanks agree that fraud in the residential mortgage markets should be prevented and fully support efforts that effectively and efficiently provide law enforcement with the information needed to detect and deter criminal activities.** There is no doubt that mortgage fraud may cause serious harm to our nation's residential real estate market and, in turn, the communities in which we live. The FHLBanks are committed to doing their part to help prevent and detect fraud in the course of operating their businesses and fulfilling their public missions.

**Existing Federal Housing Finance Agency (FHFA) fraud reporting regulations applicable to the FHLBanks support these goals.** By enacting Section 1115 of the Housing and Economic Recovery Act of 2008 (HERA), Congress authorized and instructed the FHFA to impose a requirement on the FHLBanks to detect and report fraud or possible fraud in the purchase or sale of a loan or financial instrument. Pursuant to this authority, the FHFA promulgated a fraud reporting regulation in January 2010<sup>2</sup>, issued related regulatory policy guidance in March 2011<sup>3</sup>, and provided the FHLBanks a suitable form of fraud report in April 2011. Since then, the FHLBanks have made significant strides in implementing the FHFA's fraud reporting requirements and adopting within

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<sup>1</sup> 76 FR 69204 (2011).

<sup>2</sup> 75 FR 4255 (2010).

<sup>3</sup> See: <http://www.fhfa.gov/webfiles/20685/FHFAFraudReportingGuidance32011.pdf>.

their organizations appropriate controls and procedures designed to prevent, detect, and report fraud. The FHLBanks have also dedicated significant resources towards the development of comprehensive employee training programs for fraud detection and reporting. The FHFA rules are complex and have already required substantial resources, time and effort at all levels of the FHLBanks (from individual employees through senior management and the boards of directors) to implement them, but we believe they may ultimately provide law enforcement useful information in the fight against mortgage fraud.

**Extending the BSA reporting and related operational requirements to the FHLBanks, as proposed by FinCEN, likely would not result in benefits to law enforcement commensurate with the burdens imposed on the Banks.** While FinCEN in the preamble to the Proposed Rule recognizes the existence of the FHFA fraud reporting regime and the usefulness of the reports it generates, FinCEN believes their “usefulness could be increased by including the Housing GSEs within FinCEN’s framework.” FinCEN also concludes that “the transition to compliance with FinCEN’s regulation will not be difficult or costly” because the two sets of regulatory requirements are “very similar.” The Banks respectfully disagree with these views of the anticipated benefits and costs of the Proposed Rule as it applies to the Banks. We ask FinCEN to consider the following additional factors that we believe are relevant to analysis of the costs and benefits of the Proposed Rule with respect to the Banks:

- While the preamble to the Proposed Rule contains much discussion of the importance of providing law enforcement information regarding fraudulent transactions (a view shared by the FHLBanks), there is no indication that the recently implemented FHFA fraud reporting regime is insufficient for providing law enforcement with relevant information about potentially fraudulent transactions as they relate to the FHLBanks. Under the FHFA’s regime, the FHLBanks are already required to submit Financial Institution Fraud Reports to both the Director of the FHFA as well as to the FHFA’s Office of the Inspector General, which works with other law enforcement agencies on mortgage fraud and other matters affecting the Housing GSEs. We believe it would be appropriate and reasonable to allow the FHFA fraud reporting structure an opportunity to mature and, if necessary, be enhanced through the normal FHFA regulatory amendment process, thereby maintaining a single reporting framework for the FHLBanks, rather than impose an additional, potentially duplicative, framework on top of it at this time.
- FinCEN notes that when fraud-for-profit occurs, the party engaging in fraud often commits a second crime in laundering the proceeds. Because the FHLBanks are already focused on fraud prevention and detection and obligated to report fraudulent transactions, law enforcement will obtain any information generated by the FHLBanks useful for identifying and combating fraud-related money launderers. The Proposed Rule would result in no additional benefit relating to these types of money laundering crimes.
- With respect to identifying and preventing money laundering that is unrelated to fraud, the FHLBanks typically would not be exposed to these kinds of activities due to their limited purpose wholesale funding business model and do not have access to the kinds of information that retail institutions use to detect these crimes. Moreover, we believe it would not be productive to require that the FHLBanks drastically change their business model to peer through their wholesale transactions to a much greater extent than they do today,

especially given the composition of the Banks' customer base, which is overwhelmingly composed of highly regulated entities already subject to the Bank Secrecy Act and FinCEN's enforcement power.<sup>4</sup> In this regard, the Proposed Rule would be asking the FHLBanks essentially to duplicate the efforts already required of 99.9% of their members, which are retail institutions with mature AML programs in place.<sup>5</sup> The potential additional law enforcement benefits that would be derived from imposing AMLP requirements on the FHLBanks appear minimal.

- While the goals and subject matter of FHFA fraud reporting requirements and FinCEN regulations are similar, there are many differences in the critical details, beyond those identified in the preamble to the Proposed Rule, that could make implementation challenging. The Proposed Rule would require the Banks to make significant adjustments to their anti-fraud programs to conform them to the requirements reflected in the Proposed Rule. In addition, to the extent FinCEN regulations would require the Banks to invest in new IT systems or amend member agreements to enable the Banks to obtain additional data about the members' retail customers, that would entail substantial effort and expense. As discussed further in *Exhibit A* to this comment letter, the FHFA has attempted to tailor its reporting regime to the business models of the FHLBanks, particularly through its recently issued Regulatory Policy Guidance (RPG-2011-001) (FHFA Fraud Guidance).<sup>6</sup> We encourage FinCEN to do the same to ensure that any new requirements imposed by the Proposed Rule result in benefits that justify the incremental additional costs to the FHLBanks.

The FHLBanks believe that the costs of extending the requirements of the Bank Secrecy Act to the FHLBanks, as currently proposed by FinCEN, would outweigh the potential law enforcement benefits, and we request that FinCEN consider the points above in determining whether the FHLBanks should be excluded from coverage in the final rule, and if not excluded, then subject to a

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<sup>4</sup> Based on recent membership information, 99.9% of FHLBank members are institutions already subject to the Bank Secrecy Act (i.e., federally insured depository institutions, federally insured credit unions, and insurance companies). The remaining 0.1% consists of community development financial institutions that have completed the Department of the Treasury's application process and obtained certifications from Treasury. In addition to the more than 7,500 FHLBank member institutions, the Banks also have approved applications from a small number of entities, known as housing associates, that lack membership but have limited access to Bank advances. We believe that housing associates (which are principally governmental entities) present a low risk of money laundering; and in any event, they represent only 0.83% of eligible FHLBank borrowers.

<sup>5</sup> In enacting HERA, Congress required that the FHFA, prior to promulgating any regulation that applies to the FHLBanks, consider the differences between the FHLBanks on one hand and Fannie Mae and Freddie Mac on the other. 12 U.S.C. § 4513(f). We ask that FinCEN do the same in finalizing the Proposed Rule and in particular consider the differences in how closely regulated our respective customers are. As noted above, 99.9% of FHLBank members are highly regulated financial institutions that are already subject to the BSA and to periodic regulatory compliance examinations.

<sup>6</sup> The FHFA Fraud Guidance is not referenced anywhere in the preamble to the Proposed Rule, so it is unclear whether FinCEN considered it before concluding that FHFA fraud reporting requirements are "very similar" to FinCEN regulations.

much more abbreviated and streamlined reporting regime that is more reflective of the Banks' wholesale business model and highly regulated customer base.<sup>7</sup>

**If FinCEN does impose AMLP requirements on the FHLBanks, the final rule should clarify that the Banks are not required to obtain information not already received by them in the ordinary course of business.** At one point, the preamble to the Proposed Rule suggests that the Housing GSEs may need to amend existing customer agreements to obtain additional information on “individual borrowers and the retail financial institutions who are [their] customers.” Elsewhere FinCEN indicates that the bureau “[does] not anticipate that this requirement will entail obtaining information not already received in the ordinary course of business by the Housing GSEs.”<sup>8</sup> Please confirm in the final rule that the latter statement is correct as it pertains to the FHLBanks. We believe this is appropriate given the low risk nature of the FHLBanks' activities and customer base.

**If FinCEN does subject the FHLBanks to the Bank Secrecy Act, the final rule should provide the Banks a reasonable implementation period prior to the effective date of the new requirements.** As noted above, the obligation to create an AML program would be new to the Banks. Conducting the necessary assessments, gathering and organizing customer data, and implementing new detection, monitoring, and reporting controls and processes (including, potentially, new or modified IT systems) will be a significant effort requiring substantial lead time. Modifying our existing anti-fraud programs to reflect new SAR requirements and retraining our employees on these changes will also take time, and are dependent on whether and how FinCEN and the FHFA harmonize the new rules with the old ones.<sup>9</sup> For these reasons, we request that any final rule subjecting the Banks to the BSA only be made effective upon the later of (a) the rescission or harmonization by the FHFA of its fraud reporting rules and (b) 12 months after the effective date of the final FinCEN rule.

If FinCEN does subject the FHLBanks to the Bank Secrecy Act, we also ask that the bureau consider and incorporate the technical comments of the Banks on the Proposed Rule, which are set forth on *Exhibit A* to this comment letter.

Thank you for your consideration of our comments.

Sincerely,

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<sup>7</sup> We also note that there are important questions regarding FinCEN's statutory authority to subject the FHLBanks to the BSA in light of (i) the absence of the congressionally-chartered FHLBanks from the list of types of entities expressly enumerated as “financial institutions” under the BSA and (ii) Congress's more recent enactment of Section 1115 of HERA to establish a fraud reporting process for the Housing GSEs. It is not clear why Congress would adopt Section 1115 if its intent was to include the FHLBanks within the scope of the BSA.

<sup>8</sup> We note that any individual advance an FHLBank may make to a member is typically secured by many mortgage loans, some of which may move into or out of the collateral pool frequently based on credit, underwriting, or other business needs.

<sup>9</sup> We strongly encourage such harmonization and interagency coordination. A joint rulemaking may be the appropriate vehicle to ensure that the resulting combined SAR/fraud reporting regime avoids redundant, inconsistent, and overlapping regulatory requirements.

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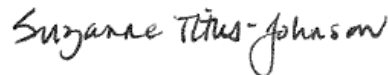
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A handwritten signature in black ink, appearing to read "Mike E. Brandeberry". The signature is written in a cursive style with a large, looping initial "M".

Mike E. Brandeberry  
Senior Vice President and Chief Counsel

**Federal Home Loan Bank of Topeka**

A handwritten signature in black ink, appearing to read "Patrick C. Doran". The signature is written in a cursive style with a large, looping initial "P".

Patrick C. Doran  
Senior Vice President and General Counsel

## EXHIBIT A – TECHNICAL COMMENTS

If FinCEN does subject the FHLBanks to the Bank Secrecy Act, we ask that you please consider the following technical comments:

1. The FHFA has taken several steps to tailor its fraud reporting requirements to the risk profile and operations of the FHLBanks. We strongly support the incorporation of these aspects of FHFA fraud reporting rules into any suspicious activity reporting requirements imposed by FinCEN, as follows:
  - a. FHFA Fraud Guidance provides that fraud detection and reporting controls “should be more expansive when a financial instrument is owned or guaranteed versus when a financial instrument serves as collateral.”<sup>10</sup> We agree, and believe this flows naturally from the principle that anti-fraud programs should be designed based on the nature and extent of the risks of fraud on the institution.
  - b. Recognizing the different risk profiles presented by the activities of the FHLBanks and the activities of Fannie Mae and Freddie Mac, FHFA Fraud Guidance provides that an FHLBank need only report fraud or possible fraud if it either (a) involves a significant fiscal, financial, or reputational impact on the Bank, (b) involves insider fraud, or (c) is part of a pattern of fraud.<sup>11</sup> FHLBanks need not report to the FHFA insignificant external incidents that are isolated and not a part of a pattern of fraud.
  - c. Under the FHFA’s definition of “possible fraud,” an FHLBank is required to conclude that it has discovered possible fraud if the institution “has a reasonable belief, based upon a review of the information available to [the Bank], that fraud may be occurring or has occurred.”<sup>12</sup> Thus, if the available evidence does not support a *belief* that fraud occurred or is occurring, then there is no “possible fraud” required to be reported. This is a more appropriate standard for the FHLBanks than that set forth in Section 1030.320 of the Proposed Rule, which instead would require reporting based only on a *suspicion* of criminal activity. The higher evidentiary standard incorporated in the FHFA fraud reporting regime will tend to produce reports that more accurately identify actual wrongdoing.
  - d. In the preamble to the final fraud regulation,<sup>13</sup> FHFA indicated that FHLBanks participating in the Mortgage Partnership Finance program may rely on the fraud discovery controls and reporting obligations of the Federal Home Loan Bank of Chicago in connection with a fraud or possible fraud associated with a transaction within that program.

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<sup>10</sup> FHFA Fraud Guidance, Section III.A.

<sup>11</sup> FHFA Fraud Guidance, Sections II.A.1. and II.B.1.

<sup>12</sup> 12 CFR 1233.2.

<sup>13</sup> 75 FR 4255 (2010).

- e. In Section 1233.3(d)(2)(ii) of its regulations, FHFA authorizes an FHLBank to “take any legal or business action it may deem appropriate, including any action involving the party or parties connected with the fraud or possible fraud,” notwithstanding the general bar on third-party disclosure of fraud reports.
2. Please confirm that the principles set forth in item 6. of FinCEN’s frequently asked questions document ([http://www.fincen.gov/statutes\\_regs/bsa/bsa\\_faqs.html](http://www.fincen.gov/statutes_regs/bsa/bsa_faqs.html)) would apply to an FHLBank’s reporting obligations, and that an FHLBank may undertake a reasonable review of a transaction or activity before the clock begins to run on its SAR reporting deadlines.
3. In the preamble to the Proposed Rule, FinCEN states that FinCEN is proposing to define the Housing GSEs as “financial institutions” under its BSA authority but that they will not be considered “financial institutions” under 31 CFR 1010.100(t) which would subject them to additional recordkeeping and reporting requirements. As set forth above, in view of the limited degree of risk presented by the FHLBanks, the FHLBanks support this limited application of the definition, the lack of additional separate reporting requirements for the GSEs (such as those set forth by institution type in 31 CFR Part 103), and the resulting exemption from any currency transaction and similar separate reporting requirements pursuant to 31 CFR Part 103.
4. Please clarify that whenever the proposed regulations refer to an FHLBank’s “customer” (e.g., in Section 1030.210(b)(1)), this refers to the FHLBank’s actual customers, and not the customers of our customers.
5. Please confirm that, in light of the FHLBank’s low risk profile as discussed above, an FHLBank would not be expected to establish new IT monitoring or data-mining systems of the kind adopted by higher risk institutions engaged in a retail business. The FHLBanks will simply be expected to be aware and diligent in detecting criminal activity as we operate our businesses in the ordinary course.