CAMS Audit – Whitepaper
Beneficial Ownership – Understanding and Shaping AML’s Fifth Pillar

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Executive Summary

Furthering a domestic initiative to strengthen the customer due diligence (CDD) requirements imposed on regulated financial institutions under the Bank Secrecy Act (BSA), on July 30, 2014, the Financial Crimes Enforcement Network (FinCEN) published a Notice of Proposed Rulemaking (NPR) whose primary purpose is to define new mandates for CDD. In scope for the NPR are financial institutions that are presently required under the BSA to have anti-money laundering (AML) programs and Customer Identification Programs (CIP). If adopted as proposed, these new rules would require the covered institutions, subject to certain exemptions, to identify and verify the beneficial owners of legal entity customers in support of their existing CDD programs and processes. Importantly, also included in the rules are proposed requirements for institutions to:

- Understand the nature and purpose of customer relationships, and
- Conduct ongoing customer monitoring.

FinCEN is also proposing to codify the four current core requirements of a financial institution’s AML program, often referred to as “pillars,” and to add a fifth “pillar” that specifically addresses CDD. As such, updates to relevant sections of the BSA are anticipated. Although generally applied to covered institutions that are subject to CIP rulemaking, FinCEN also hints at future applicability for casinos, money services businesses (MSBs) and insurance companies. The NPR requested comments to be submitted by October 03, 2014. The proposed deadline for compliance would be one year from rule finalization. As of the date of this writing, the final rulemaking has not been announced or published.

This paper endeavors to accomplish several missions—of primary importance is assisting the reader in establishing an understanding of beneficial ownership definitions and applicability within covered financial institutions as it supports their CDD programs. It will also clarify how the NPR establishes, in statute, four components of CDD as well as how these new components relate and combine to establish and codify in regulations the new ‘pillar five,’ as well as directional guidance for implementing the new regulatory requirements (once finalized) into a covered financial institution’s overall AML compliance program. Secondarily, this paper intends to provide the reader with an understanding of the history and drivers behind FinCEN’s rulemaking, and how they arrived at the proposed new requirements. It will also discuss complexities in determining legal entity ownership and control, and how intermediaries play

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1 At the time of this draft, U.S. Beneficial Ownership rulemaking continues to be in a ‘Notice of Proposed Rulemaking’ (NPR) status. As requirements are subject to change, any references within this paper to Customer Due Diligence and Beneficial Ownership rulemaking, as well as AML program pillars are intended to be those as proposed and indicated within the NPR.
into this complexity through certain gatekeeping practices. We will conclude with how proposed new legislation primarily governing tax law is being viewed as counterpart in assisting federal agencies and covered institutions in complying with international standards and best practices for AML compliance programs and regimes.

It is noted that guidance for designing and implementing CDD programs have been previously published by esteemed bodies such as the Bank of International Settlements (BIS), Wolfsberg, the Financial Action Task Force (FATF) and the Federal Financial Institutions Examination Council (FFIEC). However, for U.S. institutions the NPR represents a milestone in AML rulemaking, and the genesis of codifying CDD guidance into legal requirements. Given this perspective, and by way of apology to my international CAMS brethren as well as those reading from abroad, this paper is primarily focused on understanding and achieving compliance domestically, although I acknowledge that there will be many references included to international requirements, governing bodies, institutions and practices indicated throughout the narrative.

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“The failure to obtain adequate CDD information may impede a financial institution’s ability to detect and report suspicious or unusual activity or provide information in a filing that is useful to law enforcement. Several of the consent orders and enforcement actions issued over the last few years have identified the lack of effective CDD policies, procedures, and processes, or the underlying elements thereof, as rendering AML programs inadequate, being a significant deficiency, and an underlying factor in supervisory actions. This problem not only damages our reputation, but also undermines our efforts to join with foreign counterparts in a global offensive against organized crime and terrorism.” August, 2014 – FinCEN, Preamble to NPR, Customer Due Diligence Requirements for Financial Institutions

**Beneficial Ownership—Defined**

Within the preamble of the NPR, FinCEN acknowledges the importance of adequately defining beneficial ownership, and they admit to leveraging certain concepts which align to the FATF definition as, “refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” As such, with FATF’s definition interwoven, FinCEN’s complete definition reads as follows and includes two key approaches (prongs) in which to establish beneficial ownership:

1. **Ownership Prong**: Each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of a legal entity customer; and

2. **Control Prong**: An individual with significant responsibility to control, manage, or direct a legal entity customer, including

   (A) An executive officer or senior manager (e.g., a chief executive officer, financial officer, chief operating officer, managing member, general partner, president, vice president, or treasurer); or
   (B) Any other individual who regularly performs similar functions.

Noteworthy in understanding the definition of a beneficial owner is that it **always** is an individual or ‘natural person’—a legal person cannot, by definition, be a beneficial owner. The definition,

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2 FATF Guidance – Transparency and Beneficial Ownership, October, 2014
therefore, also speaks of “significant control”—a legal person can never be a controller, as ownership by a legal person is itself always controlled by a natural person. Other important takeaways from the definition include the use of “individual” in both prongs. Another point of note is that the two prongs serve as an independent use test—for “ownership,” financial institutions must identify each individual owning 25 percent or more (up to four); for the control assessment, institutions must identify at least one individual. In instances where ownership and control are simultaneously maintained by one party, the same individual can be identified as a beneficial owner under both prongs. A final comment on defining beneficial ownership: for entities with complex structures, the definition implies that financial institutions will ‘look through’ the complexities in establishing direct or indirect ownership.

FinCEN provides for exemptions\(^3\) to the new rules, including existing customers, and those entities currently relieved from CIP requirements including, but not limited to: 1) financial institutions regulated by a federal functional regulator (i.e., federally regulated banks, brokers or dealers in securities, mutual funds, futures commission merchants and introducing brokers in commodities); 2) publicly held companies traded on certain U.S. stock exchanges; 3) domestic government agencies and instrumentalities; and 4) certain legal entities that exercise governmental authority.

Also exempted are legal entities whose beneficial ownership detail is generally available from credible sources. Examples of such entities include, but are not limited to:

- Issuers with securities registered under section 12, or subject to reporting under section 15(d), of the Securities Exchange Act of 1934 (Exchange Act)
- Any majority-owned U.S. subsidiary of an entity whose securities are listed on a U.S. stock exchange
- SEC-registered investment companies
- SEC-registered investment advisers
- Exchanges and clearing agencies registered under section 6 or section 17A of the Exchange Act, respectively
- Any other entities registered with the SEC under the Exchange Act
- CFTC-registered entities, including commodity pool operators, commodity trading advisers, retail foreign exchange dealers, swap dealers, major swap participants, boards of trade, derivatives clearing organizations, swap execution facilities, and swap data repositories
- Public accounting firms registered under section 102 of the Sarbanes-Oxley Act
- Internal Revenue Code-qualified charities and nonprofit entities in good tax-exempt standing

Trusts are also exempted, with the caveat that certain trusts which file through a state (statutory or business trust) would be subject to the new requirements. Of note and in their purest form, real estate investment trusts (REITs) are an example of statutory trusts which would be subject to the new beneficial ownership requirements.

**Identify and Verify Requirements**

To be effective and meaningful, establishing beneficial ownership must not be reduced to a nebulously defined level of ownership or a legally defined position, such as a director of a

\(^3\) Exemptions listed here are not intended to be exhaustive. For a complete listing, please refer to the NPR at [http://www.fincen.gov/statutes_regs/files/CDD-NPRM-Final.pdf](http://www.fincen.gov/statutes_regs/files/CDD-NPRM-Final.pdf)
company or foundation, and simply adding this information to a legal entity’s customer profile. With the NPR, FinCEN is proposing that covered institutions identify and verify each beneficial owner, leveraging a standard form (for data collection and attestation from the individual opening the account on behalf of the legal entity). The form requires the identity of the beneficial owner(s) of the legal entity customer by providing the beneficial owner’s name, date of birth, physical address and social security number (for U.S. persons). Covered institutions can then rely on existing CIP processes to ensure operational and regulatory consistency. An important note on verification: It is not the intent of the new rules to require covered financial institutions to verify a beneficial owner’s status with their legal entity; rather the information supplied on the standardized form and attested to by the legal entity representative should suffice. This will likely be a point of much discussion when final rules are issued, as today’s environment of heightened expectations for AML programs would suggest a more risk-based approach to vetting beneficial ownership status.

While the NPR does not explicitly include requirements to periodically update beneficial ownership information, FinCEN does suggest that covered institutions apply a risk-based approach to maintaining current profile information on legal entities, in support of ongoing CDD and suspicious activity monitoring and reporting efforts. Reliance on other financial institutions is also recommended, where applicable and appropriate, by leveraging the similar processes for reliance agreements as documented within the institution’s CIP program. We will discuss these requirements more in the sections outlining compliance management approaches.

The Four Pillars of an AML Program, and the New Fifth

Before addressing the remaining new requirements within the NPR, it is important to quickly review the current AML program requirements, commonly referred to as the Four Pillars. In 2006 the Federal Reserve, in its Regulation K\(^4\) required Edge and Agreement corporations and U.S. branches, agencies and representative offices of foreign banks supervised by the board to establish and maintain procedures reasonably designed to assure and monitor compliance with the BSA and the regulations issued thereunder. More commonly referred to as AML Compliance Programs, other federal functional regulators made statutory updates including: 12 CFR 21.21 (OCC), 12 CFR 748.2 (NCUA), 12 CFR 326, Subpart B (FDIC), and 31 CFR 1021.100 (FinCEN). The FFIEC’s BSA/AML examination manual formalized matters in 2010, requiring financial institutions to have an AML program that consists, at a minimum, of:

1. A system of internal controls to ensure ongoing compliance,
2. Independent testing of BSA/AML compliance,
3. A designated individual or individuals responsible for managing BSA compliance (BSA compliance officer), and
4. Training for appropriate personnel.

In addition, and while not considered a “pillar” of AML compliance programs, the above regulations each mention that a financial institution’s CIP is also to be considered as a component of their AML compliance program.

With the NPR, FinCEN proposes to add a Fifth Pillar, by requiring covered financial institutions to formally incorporate into their existing AML programs:

5. Appropriate risk-based procedures for conducting ongoing CDD, to include, but not be limited to:
   - Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and
   - Conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions.

### Putting it All Together - The Third and Fourth CDD Requirements

Above we briefly discussed the existing AML program pillars; now let us package those together with the proposed Fifth Pillar—CDD—and the distinct components therein. Per the NPR and within a CDD program, the covered institution’s CIP is considered to be component one. Once the new beneficial ownership requirements discussed above are finalized, they become CDD—component two. For the third, FinCEN is proposing that covered institutions develop formal policies and procedures towards gaining an improved understanding of the nature and purpose of customer and account relationships. While it is acknowledged that these requirements are likely embedded within an institution’s existing know your customer (KYC) program, the NPR serves to codify amendments to the AML program (the four pillars) rules within the BSA. It is perceived that CDD requirements, which help improve transparency between the customers and the financial institutions, not only strengthens the effectiveness of the KYC framework, but also naturally benefits other aspects of AML programs, such as suspicious activity reporting).

Finally, the NPR proposes that as the fourth component of CDD, institutions conduct ongoing monitoring of customer transactions, ‘by, at, or through the financial institution.’ This proposed requirement does not intend for covered institutions to develop customer profile information monitoring; rather, the requirement is directed at monitoring customer account activity, i.e., transaction surveillance, which FinCEN admits should already be occurring within the institution’s existing EDD and suspicious activity monitoring programs.

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The principle that financial institutions should conduct CDD should be set out in law. Each country may determine how it imposes specific CDD obligations, either through law or enforceable means. The CDD measures to be taken are as follows:

a. Identifying the customer and verifying that customer’s identity using reliable, independent source documents, data or information.

b. Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer.

c. Obtaining information on the purpose and intended nature of the business relationship.

d. Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution’s knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

February, 2012 – Excerpt from FATF Recommendation 5
How We Arrived Here

Upon completing their Mutual Evaluation in June, 2006, FATF noted that, in addition to the need for extending AML requirements to non-financial businesses and professions, the U.S. needs to broaden their (financial institutions) CIP requirement applicability to include certain beneficial owners, while improving the accuracy of information currently collected and reported (registration agencies) on beneficial ownership of legal persons. The revised FATF 40 Recommendations on money laundering (February, 2012), represent the international standard on the issues of CDD and beneficial ownership. FATF notes the importance of ensuring transparency of legal entities and arrangements and of identifying the beneficial owner through various references. According to Recommendations 5 and 12 on CDD, financial institutions (and other financial intermediaries) should be required to establish the identity of the beneficial owner of a legal person or arrangement. FATF Recommendations 33 and 34 suggest countries ensure there is adequate, accurate, and timely information on the beneficial ownership and control of legal persons (33) and legal arrangements (34), and that this information can be obtained or accessed in a timely fashion by competent authorities.

In March 2012, one month following FATF’s revising and publishing their CDD and beneficial ownership recommendations, FinCEN released its first Advanced Notice of Proposed Rulemaking (ANPRM), intending to “solicit public comment on a wide range of questions pertaining to the development of a customer due diligence (CDD) regulation that would codify, clarify, consolidate, and strengthen existing CDD regulatory requirements and supervisory expectations, and establish a categorical requirement for financial institutions to identify beneficial ownership of their accountholders....” Comments were requested by May 2012, and after much outreach to both regulatory agencies and financial institutions, the NPR was issued in mid-summer, 2014.

Euro-change

Since 2005, the European Union (EU) has required financial institutions to identify and verify beneficial owners. Other international financial centers such as Switzerland, Singapore and Hong Kong require the same. In February 2013, the European Commission proposed the Fourth EU Money Laundering Directive, which would require companies, legal entities and trustees to hold adequate and up-to-date information on their beneficial owners and to make this information available to persons performing AML due diligence and to law enforcement agencies. Last March, the European Parliament released a separate proposal, which included a requirement for a central registrar of beneficial owners. In December 2014, the European Council and Parliament reached an agreement that would require beneficial owners to be listed in central registers available to the government, "obliged entities" such as financial institutions, and persons who demonstrate a "legitimate interest." While still finalizing the Fourth EU

Directive, the message is clear: While the rules concerning beneficial ownership vary across jurisdictions, they are tightening globally and especially within the EU.

**Complexities in Compliance**

Much has been written of, and in this paper we will not review the many varieties of legal entity structures such as partnerships, trusts, LLCs, etc., nor will we explore the phenomenon of shell or shelf corporations. However, in this next section we cover challenges that covered institutions will likely encounter with establishing true identities of ownership of these companies, as well as difficulties encountered with drilling down into the additional levels and layers of ownership and control. While most of us will agree that it is difficult to imagine a banking environment where knowing the identity of individuals owning and in control of your corporate customers is not a concern, it is especially troubling given that some corporations or other types of business entities are established solely for the purpose of laundering money by providing anonymous access to financial institutions. There is also evidence of similar misuse of these entities in the context of other criminal and illicit behaviors, including the funding of terrorist organizations. In addition, a lack of knowing and screening corporate directors, officers, and signatories creates significant blind spots in CDD, economic sanctions (OFAC, et.al.), and politically exposed persons (PEPs) control measures.

Where entities are formed for the sole purpose of laundering money or otherwise disguising the source and destination of funds, they often share a number of common characteristics, such as:

1. The entity in question is a company, corporation or other business enterprise;
2. The entity is misused to hide the money trail;
3. In instances of malfeasance, proceeds and instruments of illicit activity consist of funds in a bank account; and
4. In instances where the ownership information was difficult to determine, the entity in question was typically established or managed by a professional intermediary.

Corruption involving legal entities often involves the use of added layers of “legal distance” between the corrupt beneficial owner and his assets. These layers make the beneficial owner’s connection to money laundering less apparent to investigation, and allow the owner to deny ownership or control of such assets if they are discovered. Due diligence is particularly complicated when such layers are intentionally placed in multiple jurisdictions, where typically multiple financial institutions are involved and multijurisdictional privacy laws inhibit investigations. Relevant documentation may be dispersed across different geographies, so that collecting information on a particular entity that is incorporated or formed under the laws of Country Y, but administered from Country Z, can be daunting. Furthermore, a corporate structure consisting of layers of legal entities and/or arrangements that are inserted between the individual beneficial owner(s) or controller(s) and the assets of the primary corporate vehicle, pose additional challenges for covered institutions. The use of these ‘tiered’ entities affords a beneficial owner further opportunities to place key pieces of ownership, control and assets across multiple jurisdictional boundaries. This structure makes it easier to access financial institutions in the names of different entities, which serve the same ultimate end, and to maintain control over the primary corporate vehicle (that is, the vehicle holding, receiving, or transferring the asset). Tiered entities enable the beneficial owner to meet these goals while remaining obscured by a complicated organizational and ownership hierarchy.
For larger entities, much information about major shareholders, board of directors and senior management is likely in the public domain. And while we will discuss compliance management later, one strategy in dealing with a multinational company is for the covered institution to exclude from consideration those who ultimately own or control the company, and are unlikely to pose much money laundering risk. In this way once ownership is established or known, the focus can then be, from an anti-corruption/AML point of view, on the identity of the company employee who is ultimately controlling the account(s) or financial relationship. As an example, transactions in question may be designed to facilitate payment of a bribe, to set up a slush fund, or perhaps to defraud the company. But who ultimately requested/facilitated them? It is unlikely that a beneficial owner of the company would be involved at this level, but it may well be someone of much lower rank within the management structure. Leveraging this approach supports the need to establish beneficial ownership using the control prong method mentioned earlier.

Excessive complexity in a corporate vehicle structure can be a good “red flag” indicator of risk. Another is the entity’s use of a surrogate as a particularly effective way of increasing the opacity or obscurity of a potential scheme’s true ownership. For example, a legal entity will usually be subject to registration in some form or capacity, in which case at least basic information on their management and control is publicly available or accessible. Yet, in instances of corruption the principal actor can plant evidence that leads to the surrogate and thereby conceals his or her own connection back to the entity.

Unregulated Conduits

In 2006 the Government Accountability Office (GAO) issued a report on the misuse of domestically formed companies for money laundering, and the lack of beneficial ownership information collected by virtually all of the corporate registries (conduit type 1) operating in the U.S. Additional data revealed that the lack of ownership information collected by the various states is impeding law enforcement investigations domestically, as well as the ability to respond to requests from foreign enforcement agencies. The U.S. has no legal data collection requirement that companies form and register through state-run agencies. Individuals may

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form and register companies on their own, and through a variety of independent incorporation agents via telephone, direct mail or online registration.

Whether sponsored by states or an independent practitioner, registries and incorporation agents generally take information on good faith; with most documents and filings being accepted at face value unless there are obvious or blatant errors. Verification of the legitimacy of the applicant, either through independent sources or physical site visits does not happen. The information supplied by the applicants is self-declared, with little assurance as to accuracy or veracity. Updates to entity information, made either during the time of registration or as a result of changes post-registration is solely the responsibility of the person(s) representing the legal entity. Because compliance with the responsibility to update information tends to be poor, information in registries is generally viewed to be out of date. The root cause lies in the fact that in most cases, the legal entity applying for registration had to merely complete an online form, a process often simpler than applying for most grocery store rewards programs.

A broad category of incorporation agents, known as Trust and Company Service Providers (TCSPs) or gatekeepers, includes attorneys, paralegals, certified public accountants (CPAs), and other professionals who perform such services (conduit 2). TCSPs are not considered covered institutions subject to U.S. AML laws; therefore, requirements such as customer identification, CDD and suspicious activity reporting do not apply as a primary matter of course. Attorneys who are directly engaged in certain transactional activities on behalf of their clients are in a good position to obtain the relevant information on the ownership and control structure of a corporate vehicle. For that reason and in certain jurisdictions FATF, through its Recommendation 22\(^9\) has subjected lawyers and other legal professionals to due diligence obligations when performing certain services. The recommendation requires these professionals to report transactions to their respective financial intelligence units (FIUs) when they encounter anything suspicious in dealings with their clients. However, information obtained under circumstances that are subject to attorney-client privilege does not fall within the same reporting obligations. As a result, frequent arguments against the inclusion of TCSPs within the U.S. AML framework are based on the premise that when lawyers or other TCSPs are facilitating criminal conduct, they rarely do so unwittingly. So the question becomes: What is the point of imposing an obligation to report suspicious transactions when the overwhelming majority of transactions will go unreported?

**“Rubber, Meet Mr. Road”—Strategies for Compliance**

How can covered financial institutions best conform to the new beneficial ownership requirements? For starters, the standard approach most institutions use for achieving compliance with new regulatory requirements should be leveraged. While we will not explore in detail all of the compliance management program concepts and practices such as risk assessment, determining regulatory applicability, assigning risk levels/taking risk-based approaches, and implementing compliance monitoring and testing, we will discuss a few important strategies to consider. Paramount to achieving success with implementing these new requirements is determining to what areas within a covered institution they apply. Understanding and applying the definition of ‘legal entity’ within the NPR is a good place to begin. For example, certain lines of businesses with consumer-only account relationships and product offerings can likely be ruled out as having significant impact, although account types and product nuances should first be assessed to determine possible exposure. The legal entity

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definition should also be applied to further rule out additional lines of businesses, and institutions should review and consider certain exemptions from the NPR, such as trusts, Intermediated Accounts and pooled investment vehicles.\textsuperscript{10} In similarity with CIP, existing accounts are also exempted, although FinCEN encourages covered institutions to apply their existing CDD control measures, along with the proposed ‘new’ CDD requirements to their current and existing portfolios.

Once the heavy lifting of determining applicability has been completed, and impact assessments have been performed to determine any changes to existing compliance programs, is when modifications to policies, procedures, processes, systems, controls, and monitoring regimes can begin. From the outset, it is helpful that the NPR allows for the identification of additional parties to be incorporated into and aligned with current CIP programs. As a result, a covered institution’s existing CIP should be able to accommodate beneficial owners without much incremental infrastructure. Furthermore, the proposed standardized beneficial ownership certification, via the new form for obtaining legal entity ownership information, assists in taking the guesswork out of what information covered institutions are expected to obtain about their legal entity customers’ beneficial owners. A note on the use of the standardized form and possible hidden benefits, if covered institutions are required to use comparable methods and criteria for determining beneficial ownership and performing CDD, theoretically this requirement could assist in creating a more level playing field. Also, standardization virtually eliminates bank ‘shopping,’ a strategy employed by corrupt clients attempting to circumvent KYC controls.

In light of the NPR’s addition of the new Fifth pillar, as well as its codifying the additional CDD requirements, there will be an impact to a covered institutions written program, i.e., the AML policy. Modifications will likely be made to written standards and procedures, regarding what or rather who, is to be considered “customers” as a result of the beneficial ownership requirements. Furthermore, client onboarding processes and systems will need to be updated to account for the new relationships and supporting documentation, perhaps including how to automate (digitize) the new certification form. For larger covered institutions this automation is likely a foregone conclusion.

Staying with onboarding a moment, and because of the nature of the legal entity customer, wholesale and small business banking client or relationship managers (CM/RM) are a pivotal component of beneficial ownership compliance, and AML compliance as a whole. It is these employees who first interact with a prospective client, so it naturally falls to a CM/RM to completely understand the ownership and control structure of a prospective or existing client. Ideally, these client managers have already had extensive training on the current KYC requirements and their significance (and nuances) with international and domestic corporate and/or small business clients. Because of their criticality in complying with the beneficial ownership requirements, it is recommended CM/RMs, business leads and their support staffs undergo targeted training on the new requirements. Goals of training could include understanding the key terms and definitions within the NPR, gaining a clearer understanding of the beneficial ownership vs. control prongs, the use of the new standardized form, how to identify customers including ‘agented’ or ‘participated’ loans, beneficial owners and other related parties subject to CDD, and an understanding of what institutional resources are available to manage their broader CDD requirements and to assist in meeting a covered institutions regulatory responsibilities.

\textsuperscript{10} Covered financial institutions are cautioned that these definitions and for proposed exemptions, which could change with the issuance of the final rulemaking.
However, training should not be limited to line of business staff. Establishing a clear understanding of the new requirements, and how they impact a covered institution among compliance, risk, audit and even outsourced third parties who are integral to an institutions onboarding risk management and compliance is critical to achieving success. Senior management and the board of directors should also be trained on the new Fifth Pillar. A deliberate focus on training related to the new rulemaking is necessary to ensure covered institutions maintain and evidence compliance with the Fourth Pillar—training for appropriate personnel.

Rounding out strategies for compliance with the new requirements is an ability to conduct ongoing monitoring of the customer, any beneficial owner, and any other related party profiles, as well as relevant account-level monitoring. Customer-level monitoring will likely need to be modified from existing CIP monitoring to full profile monitoring, and supplemented by account level monitoring (i.e., accounts are generally the linkage between various profiles not otherwise viewed as related). Account-level monitoring should already exist in some form, but will now need to be designed and formalized to reflect compliance with the new Fifth Pillar.

Some might ask what good it would do to require that companies identify beneficial owners on incorporation documents, because, without verification, someone who intends to use a company for illicit purposes can just lie on the documents. That may be the case, but from the perspective of law enforcement, there is an enormous difference between a document that does not require certain information to be provided, and a document that falsely reports required information. The most obvious distinction is that the latter can provide law enforcement with a criminal charge: In New York, it is a felony to file a false business record. – June, 2015 – Excerpt from testimony of New York County District Attorney Cyrus R. Vance, Jr., before the U.S. House of Representatives Task Force to Investigate Terrorism Finance

Looking Ahead: Impacts/Correlations from Recent Legislative Actions (OFAC, FATCA)

As discussed previously, achieving compliance with the new beneficial owner requirements will also have a (ideally) positive impact on a covered institution’s economic sanctions compliance program. In certain cases sanctions risks are triggered where the ultimate benefit of a transaction on behalf of a legal entity is received in a sanctioned country. These risks also apply to beneficial owners located in that country. In August of last year, OFAC modified their guidance and now aggregates beneficial owner interests of sanctions targets—where two or more sanctions targets combined own 50 percent or more of a legal entity, the sanctions will also apply to that entity. As a result, for covered institutions the accurate identification and documentation of beneficial ownership now becomes an integral part of OFAC compliance.

From an overall domestic legislative viewpoint, and in the spirit of responding appropriately to FATF’s prior concern regarding U.S. transparency laws, the Foreign Account Tax Compliance Act, or FATCA, introduces a glimmer of hope. Congress enacted FATCA to address

12 FATCA includes requirements for foreign financial institutions to report on domestic account holders, as well as requiring domestic institutions to withhold certain payments for non-compliance: http://www.gpo.gov/fdsys/pkg/FR-2013-09-10/pdf/2013-22004.pdf
noncompliance by U.S. taxpayers using foreign accounts. By requiring foreign banks to report information to the U.S. Internal Revenue Service (IRS) about accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest, FATCA enhances the level of transparency for cross-border financial transactions. It also provides valuable data to law enforcement that was previously very difficult to identify and obtain. Unlike the 25 percent ownership threshold in the NPR, FATCA imposes a higher bar—10 percent beneficial ownership identification threshold—in an effort to identify and classify clients accurately and appropriately. This change in the scope of the law is considered good news, and as a result, foreign banks with considerable exposure to U.S. taxpayers are already collecting more data and providing better documentation on beneficial owners than ever before. There also seems to be stronger enforceability to FATCA, as it requires U.S. financial institutions to withhold a portion of certain payments made to foreign financial institutions that do not agree to identify and report information.

Notwithstanding the positive impact of change brought on by FATCA, there may also be some downside. Within Treasury’s sister departments, FinCEN and the IRS, there appears to be contradictory standards in determining thresholds for beneficial ownership. As currently proposed, FinCEN’s NPR has a lower bar for determining beneficial ownership despite the greater risks to national security (The argument here is that a more stringent 10 percent is leveraged by the IRS to identify tax evaders who presumably do not pose any threat to U.S. national security via money laundering/terror financing activities).

Despite this paper’s domestic slant, the U.S. should not be viewed in isolation due to the manner in which the global financial system is connected. FATCA and the NPR will have a significant impact on U.S. banks and their subsidiaries operating in foreign countries. Given the global impact of FATCA and the significant number of foreign banks now having to comply, the argument could be made that one consistent target percentage for determining the threshold for beneficial ownership would be optimal and facilitate improved conformance with both sets of requirements, NPR and FATCA.

A final note regarding pending beneficial ownership legislation:

Sen. Sheldon Whitehouse (D-RI) is considering the introduction of a measure similar to one proposed by since-retired Sen. Carl Levin (D-MI), according to multiple sources. Levin, who left Congress in December, previously championed legislation that would have tasked corporate formation agents with collecting data on the owners of entities created under state laws. The ‘Incorporation Transparency and Law Enforcement Assistance Act’ directs the Secretary of the Treasury to, among other things: (1) issue regulations requiring corporations and limited liability companies formed in a state that does not have a formation system providing for the disclosure, updating, and verification of beneficial ownership information to file with the Secretary information about their beneficial ownership as required by this Act; and (2) provide such information pursuant to a civil or criminal subpoena or summons from a federal or state agency or a congressional committee or a written request by a federal agency on behalf of another country or by the Financial Crimes Enforcement Network. In March, 2015, Whitehouse’s office confirmed that he would “reintroduce” a measure in the Senate Judiciary Committee, now headed by the strongest Republican supporter of Levin’s bill, Sen. Charles Grassley (R-IA). “Sen. Grassley is evaluating the different proposals on the table, trying to see what will be most effective,” said Taylor Foy, spokesperson for the Senate Judiciary Committee.
Additional References

