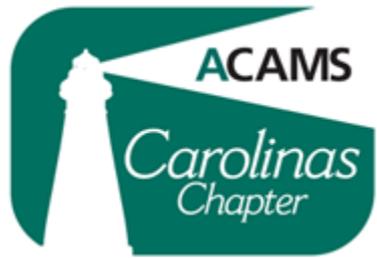




Dissecting FinCEN's Customer Due Diligence Rule: Understanding the final rule and preparing for implementation

The views expressed in this presentation are strictly those of the author[s] and do not necessarily represent the views of their employers.



CDD Final Rule

The long journey



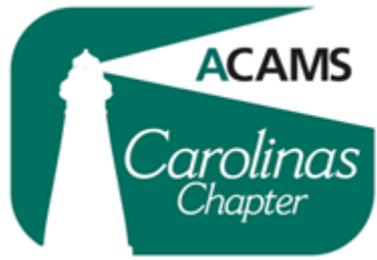
Background: the need for customer due diligence

- Concern regarding risks with shell companies and trusts identified in 2007 National Money Laundering Strategy
- United Nations stated that abuse of illegal entities is an international problem as far back as 1998
- GAO report focused on vulnerabilities with company formation requirements in the United States
- Department of the Treasury's attempts to address beneficial ownership challenges through legislation never gained traction



Background: the need for customer due diligence

- Law enforcement has repeatedly reported that major drug trafficking organizations use shell companies to launder drug proceeds
- Increased global focus on financial transparency through G7/G8, G20 and FATF
- Indirect reliance of FATCA and corresponding foreign approaches to tax reporting on beneficial ownership collected through CDD



Background: the need for customer due diligence

Financial Action Task Force (FATF)

- United States was primarily criticized for:
 - lack of sufficient CDD regulatory requirements, particularly with regards to capturing information on beneficial ownership
 - lack of requirements to collect beneficial ownership information under company formation laws



The Path Towards a Final CDD Rule

2001

- CDD principles for Private Banking were outlined in Section 312 of the USA PATRIOT Act

2010

- Interagency Guidance—compilation of regulations, rulings and guidance covering CIP, private banking and correspondent banking

2012

- FinCEN Advanced Notice of Proposed Rulemaking

2012

- FinCEN invited private sector to weigh in on definitions, current practices, verification and challenges associated with certain products, services and relationships

2014

- FinCEN Notice of Proposed Rulemaking addressed “regulatory flexibility analysis”, designed to examine the cost-benefit

2014

- Public comment commenced

2015

- FinCEN published a Regulatory Impact Assessment and Initial Regulatory Flexibility Analysis with a request for comment

2016

- Final CDD rule published with final effective date of May 11, 2018



Benefits of the Rule (per FinCEN)

- For law enforcement
 - Transparency is less attractive to criminals
 - Providing inaccurate information demonstrates unlawful intent
 - Generates leads to identify additional evidence or co-conspirators
- For Financial Institutions (FIs)
 - Levels the playing field, compliance no longer competitive disadvantage
 - FIs can better manage their own risk and enhance SARs
- Supports tax compliance (FATCA)
 - US committed to pursuing equivalent levels of reciprocal information exchange
- Supports other strategic goals for improved transparency
 - Collection of beneficial owner information at the time of legal entity's formation
 - Global implementation of international standards regarding CDD and beneficial ownership of legal entities

Customer Due Diligence Requirements

Key Elements of Final Regulation



4 Key Elements of Customer Due Diligence

There are four key elements of customer due diligence (CDD):

- I. Customer Identification and Verification } **Current CIP**
- II. Beneficial ownership identification and verification } **NEW! 31 CFR 1010.230**
- Appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:
- III. Understanding the nature and purpose of customer relationships to develop a customer risk profile; and } **Amends BSA to add "5th Pillar" but viewed as restating existing expectations [31 CFR 1020.210]**
- IV. Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk-basis, to maintain and update customer information }



I. *Customer Identification and Verification*

I. *Customer Identification and Verification*

- Pre-existing requirement under Customer Identification Program (CIP) requirements [31 CFR 103.121]



II. Beneficial Ownership

II. Beneficial ownership identification and verification

- Must identify and verify the identity of beneficial owners of all legal entity customers (other than those excluded) for each new account at the time a new account is opened (other than accounts that are exempted)
- Compliance is achieved by obtaining certification in the form of Appendix A or the equivalent information with certification of the accuracy of the information
- May rely on beneficial ownership supplied by the customer, provided FI has no knowledge of facts that would reasonably call into question the reliability of the information
- Verification of identity of the beneficial owners should contain the elements required for verification under CIP, but FIs may rely on copies of IDs provided by the person opening the account

III. Nature and Purpose

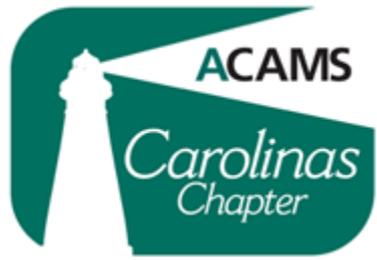
III. Understanding the nature and purpose of customer relationships as a means of developing a customer risk profile

- In combination with “conducting ongoing monitoring”, forms a new “5th Pillar” of expectations for an AML Program [31 CFR 1020.210]
- Intended to be a baseline understanding of the client
- May include self-evident information about the type of customer or type of account, service or product. Might also include basic customer information (annual income, net worth, occupation, etc.)
- Customer risk profile may, but need not, include a system of risk ratings or categories of customers
- Does not require creation of a “risk score”

IV. Ongoing Monitoring

IV. Conduct ongoing monitoring to identify and report suspicious transactions and, on a risk-basis, to maintain and update customer information

- Customer information includes beneficial ownership information.
- “Customer risk profile” may, but is not required to be, integrated into automated monitoring system and may be used as one means of determining whether or not the activity is suspicious.
- FinCEN acknowledges that a change in beneficial ownership is unlikely to be identified through transaction monitoring. However, when an FI detects information about the customer that is relevant to re-assessing the customer’s risk, it must update the customer information, including beneficial ownership information. This could include significant/unexplained change in customer activity.
- Updates to beneficial ownership should be event-driven as part of normal monitoring, not as a categorical requirement on a continuous or periodic basis. Applies to all legal entity customers, including existing customers.
- All accounts must be monitored on risk-based approach (not just those subject to the final rule).



Who is the Beneficial Owner?

1. Ownership Prong

- 25% ownership “directly or indirectly”—not intended to identify nominees or “straw men”
- FinCEN “does not expect financial institutions or customers to undertake analyses to determine whether an individual is a beneficial owner under the definition”
- Not obligated to determine or inquire if ownership has been structured to avoid tripping the 25% level, but SAR may be appropriate if you determine the owners did
- If no one meets the 25% ownership level, can be completed as “N/A”
- Trustee is considered “owner” if trust owns 25% or more of equity interest

2. Control Prong

- One person at sufficient level, “significant management responsibility”
- Managerial control, not administrative control

Even if no one meets the 25% ownership level, you must still identify a control person.



What is required for beneficial owners?

- Identification of individuals meeting ownership and control prongs
 - “4 CIP elements” for individuals meeting the ownership and control prongs
- Verification of beneficial owners
 - Verify the identity of the individual as a person, not their status as the owner
 - Copies of photo IDs are acceptable
 - For banks using non-doc, be sure there is not a Fair Credit Reporting Act violation
 - Verification must be completed within a reasonable time period after the account is opened
 - Procedures must address circumstances where the financial institution cannot form a reasonable belief that it knows the true identity of the beneficial owner(s)
 - Banks are not required to maintain copies of IDs, only a description of the document—if planning on retaining copies, talk with consumer compliance for fair lending nuances
- Requirements are a floor, not a ceiling and FIs may do more in circumstances of heightened risk



Appendix A

II. CERTIFICATION OF BENEFICIAL OWNER(S)

Persons opening an account on behalf of a legal entity must provide the following information:

a. Name and Title of Natural Person Opening Account:

b. Name and Address of Legal Entity for Which the Account is Being Opened:

c. The following information for 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 the legal entity listed above:

Name	Date of Birth	Address (Residential or Business Street Address)	For U.S. Persons: Social Security Number	For Foreign Persons: Passport Number and Country of Issuance, or other similar identification number ¹

(If no individual meets this definition, please write "Not Applicable.")

d. The following information for one individual with significant responsibility for managing the legal entity listed above, such as:

- An executive officer or senior manager (e.g., Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, Treasurer); or
- Any other individual who regularly performs similar functions.

(If appropriate, an individual listed under section (c) above may also be listed in this section (d)).

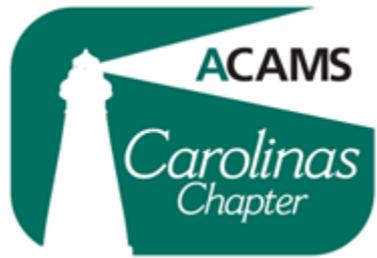
Name/Title	Date of Birth	Address (Residential or Business Street Address)	For U.S. Persons: Social Security Number	For Foreign Persons: Passport Number and Country of Issuance, or other similar identification number ¹

I, _____ (name of natural person opening account), hereby certify, to the best of my knowledge, that the information provided above is complete and correct.

Signature: _____ Date: _____

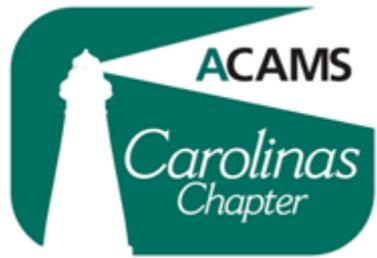
¹ In lieu of a passport number, foreign persons may also provide an alien identification card number, or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

Legal Entity Identifier _____ (Optional)



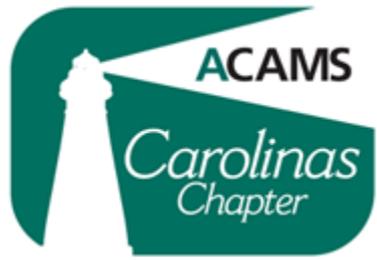
Appendix A

- Completion of Appendix A is not a “safe harbor”.
- Banks are permitted, but not required, to use certification form.
- Bank may obtain the information required on the form by other means, provided *the individual certifies, to the best of the individuals knowledge, the accuracy of the information.*
- The certification can be obtained “in the same way the FI obtains other information from its customers in connection with its account opening procedures”.
- Banks may rely on beneficial ownership information supplied by the customer, provided FI has no knowledge of facts that would reasonably call into question the reliability of the information.



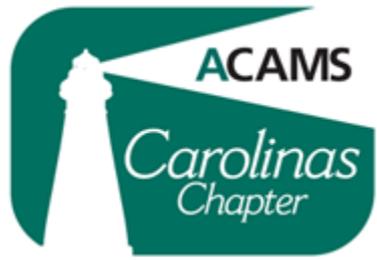
What is the definition of Legal Entity Customer?

- Corporation
- Limited Liability Company
- Similar entity created by the filing of a public document with a Secretary of State or similar office, or formed under the laws of a foreign jurisdiction
- This includes limited partnerships, business trusts created by a filing with a state office, and general partnerships



Legal Entity Customer does NOT include the following

- Regulated financial institution, including bank/financial holding companies
- Those customer types already exempt under CIP: 1) US or state governmental entity or one that exercises governmental authority, 2) listed publicly traded firm on US exchange or an entity owned 51% or more by listed entity
- Entities registered with the SEC: a) Issuers of securities registered under section 12 of Securities Exchange Act of 1934, b) Investment company registered with the SEC, c) Registered investment advisor, d) Exchange or clearing agency, e) Commodity or swap dealer
- Public accounting firm registered under section 102 of the Sarbanes-Oxley Act
- Pooled investment vehicle operated or advised by a FI excluded under the rules
- Insurance company regulated by a State
- Financial market utility designated by the Financial Stability Oversight Council (Dodd Frank)
- Foreign FI established in a jurisdiction where the regulator requires beneficial ownership information
- Non-US governmental department, agency or political subdivision that engages only in governmental rather than commercial activities
- Private banking relationships as defined in Section 312 of the USA PATRIOT Act



Additional exclusions from the final rule

Although these are not called out in the final rule itself, the following are also not included:

- Does not include sole proprietorships or unincorporated associations
- Does not include trusts (other than statutory trusts created by a filing with a Secretary of State or similar). Trusts are generally a contractual arrangement. However, rule does not supersede existing obligations regarding trusts generally, and FinCEN highlights need to look through, obtain information on trustee and obtaining info on settlor, grantor or others with regards to revocable trusts.
- ERISA accounts continue to be excluded*
- Intermediated account relationships—continue to rely on existing CIP guidance which says the intermediary itself is the customer (such as escrow accounts)

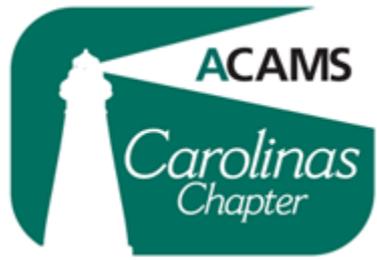
*non-ERISA employee benefit retirement plans, still have to verify beneficial ownership for the employer unless the employer is considered exempt



Special Circumstances

Certain legal entity customers are subject only to the control prong of the beneficial ownership requirement:

- *Non-excluded* pooled investment vehicles (non-US mutual funds, hedge funds, private equity funds)
- Charities and non-profits—complexity with NPRM exclusion. Now excluded from ownership prong, just control prong



Other esoteric exemptions for beneficial ownership

In the following circumstances FIs are exempt from the requirement to identify and verify beneficial ownership:

- Private label retail credit accounts established at the point of sale as long as certain caveats apply (used only domestically, taken in the name of business clients, with credit limits less than \$50,000)
- Accounts established for the purchase and financing of postage
- Commercial accounts to finance insurance premiums
- Accounts to finance the purchase or lease of equipment

...as long as certain restrictions hold true, such as no 3rd party transactions or cash refunds



Bonus From the Commentary

- FIs should use beneficial ownership info as they use other information they gather regarding customers:
 - OFAC—requirement to block property and interests owned more than 50% by an SDN so generally should scan.
 - Also explicitly stated that FIs should develop risk-based procedures to outline additional screening, such as negative media.
 - CDD may provide banks with new information in order for them to apply existing expectations for CTR aggregation for transactions are “on or behalf of” the same person, where an individual owns all or substantially all of the legal entity’s equity interests (FIN-2012-G001, FinCEN Ruling 2001-2)
 - 314(a)—FinCEN does not expect the CDD rule imposes additional requirements, and does not authorize reporting of beneficial ownership information associated with an account or transaction matching a named subject (so if business XYZ matches, don’t provide owners A, B and C. But what if the subject is owner A? Should you report or not?)

Customer Due Diligence Requirements for Financial Institutions

Considerations for the Final Rule

Considerations for Implementation

Understand the tenets of the new rule and begin to examine how the new rule will affect your institution

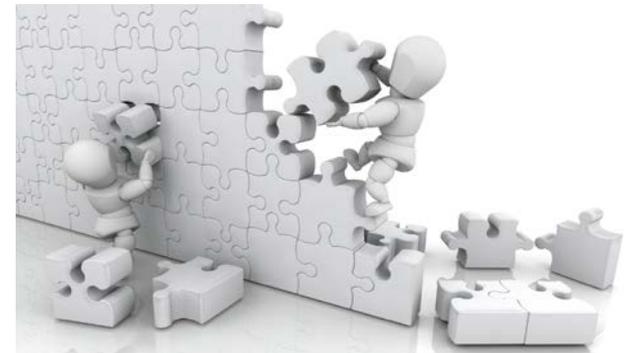
What business lines or departments will be impacted?

Where will new or enhanced processes be needed?
Policies? Procedures? Training? Technology?
Vendors?

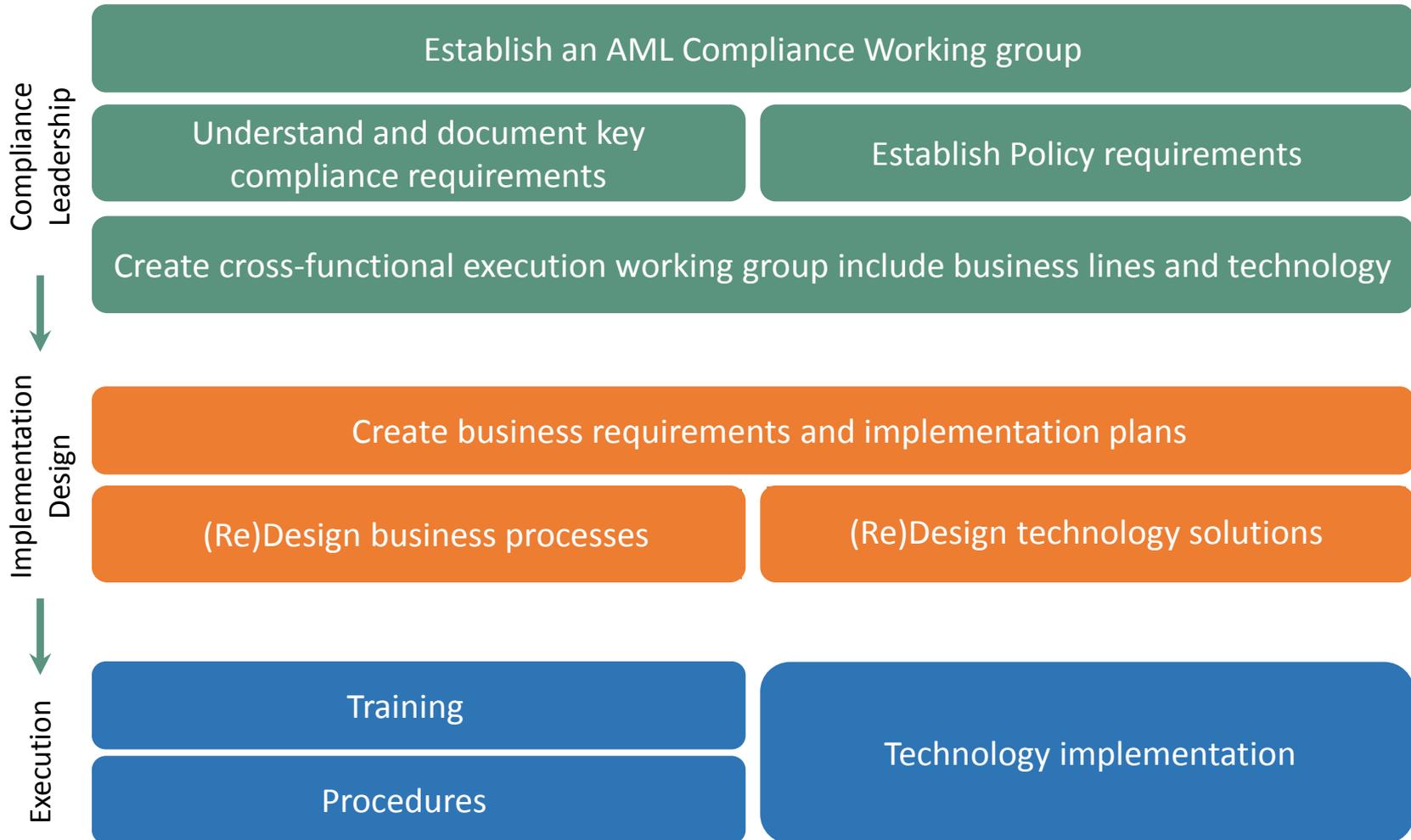
Develop plan for business readiness. How will I prepare people for the changes? Are the changes minor or significant?

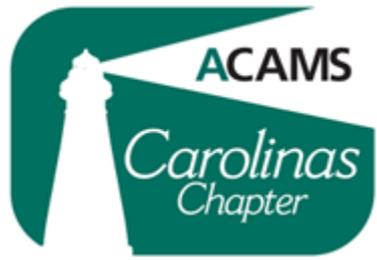
Build a coalition of affected stakeholders

Begin to develop a plan, and provide internal education to your stakeholders



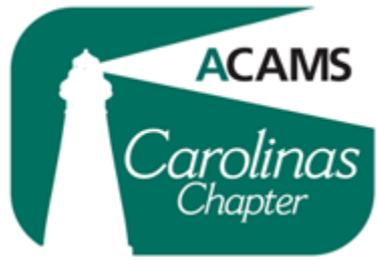
Implementation Approach Example





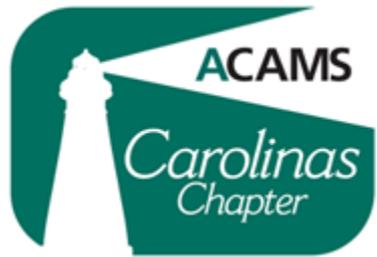
Questions to Consider

- Can banks leverage individual CIP information when the customer is also a beneficial owner of a covered legal entity?
- Must beneficial information be obtained each time an account is opened for a covered legal entity customer? Every single time?
- Is there an expectation to corroborate what the client has told you about ownership? Must you be able to evidence the accuracy of what the client has told you through your own documentation of ownership?
- Do you have to provide the CIP notice to each beneficial owner or does the pre-amble to Appendix A count?
- Is there a hidden retroactive requirement to refresh CDD on existing clients?
- Should an account be restricted if one beneficial owner hasn't been verified for various reasons (out of the country, ID expired, etc)



Questions to Consider

- If you currently identify beneficial owners at a lower ownership percentage, should you change your policy as the result of the regulation?
- If you have already identified beneficial owners as a matter of bank policy, must you re-obtain this information when a new account is opened after the effective date?
- How should “trigger event” be defined for purposes of updating beneficial ownership information? Every investigation? Every SAR? Something different?
- Is it now an expectation to obtain anticipated transaction activity and monitor for deviations from stated activity?

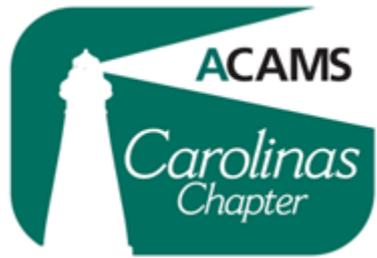


Examples

Q: If a covered legal entity opens an account and in turn, four legal entities each have a 25% ownership, what information must be collected?

A: It depends on specifics of the ownership of each of the legal entities having 25% ownership. If each legal entity has multiple, unique (different) owners, such that there are no individuals with 25% or more ownership, then no beneficial owners are noted under the ownership prong; however one individual must be identified under the control prong.

A: If, however, each of the four legal entities is owned by a single individual (and therefore 4 individuals ultimately have ownership of 25% each) then the person opening the account should list the 4 persons under the ownership prong plus 1 individual under the control prong.



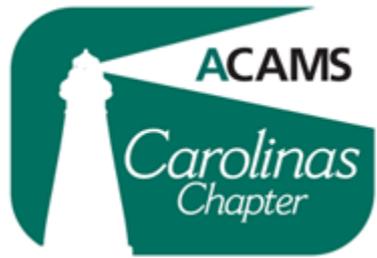
Examples

Q: Your legal entity customer, a family business, is owned by 5 siblings each with equal share. What information must you collect?

A: Similar to the prior example, there are no individuals with 25% or more ownership, however one individual must be identified under the control prong.

Q: Your legal entity customer, XYZ Corporation, recently had a publicly-traded company take a 30% ownership interest, with the remaining 70% ownership held by the original three founders of the company. For whom must you collect information?

A: The publically-traded company owning 30% of XYZ Corp is considered exempt so therefore they would not be included as a beneficial owner relative to that entity's interests. If any one of the three original founders owns 25% or more interest in the entity, they would need to be identified as a beneficial owner plus one individual under the control prong.



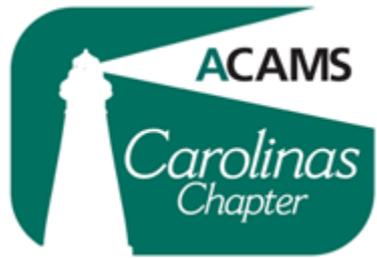
Examples

Q: The Trustee of a Trust account approaches your bank about opening a checking account. Whom must you identify?

A: Under the Final Rule, a trust generally does not fall within the definition of a legal entity (other than those created by a filing with a state). Therefore the beneficial ownership requirements would not be applicable. However, FinCEN notes that CDD rules don't supersede existing obligations regarding Trusts, so prudence would dictate that you obtain information on the Trustee, and possibly other parties to the Trust (settlor, grantor, etc).

Q: Your customer, Love, Inc, is owned 100% by a Trust. Whom must you identify?

A: Because the trust directly owns more than 25% of the legal entity customer, the CDD rule notes that the beneficial owner under the ownership prong is the Trustee. Additionally, a control prong owner must be identified.



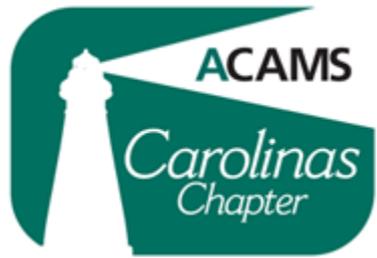
Examples

Q: You are opening an account for a charitable organization, which receives donations primarily from several large donors in the US and Canada. Its charitable missions focus on the availability of clean water in Haiti. Whom must you identify?

A: Under the Final Rule, charities are excluded from the ownership prong requirement if it has filed organizational documents with the appropriate State authority. An individual under the control prong should be identified.

Q: You are opening an account for the local Boy Scout troop (the account is for use of the local troop, not the national organization). Whom must you identify?

A: An unincorporated association is not covered under the final rule, so no individual would be covered under the CDD rules. However, general practices may dictate that the signor on the account is identified.



Resources

- http://www.fincen.gov/statutes_regs/guidance/html/fin-2010-g001.html
- <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/internationalstandardsoncombatingmoneylaunderingandthefinancingofterrorismproliferation-thefatfrecommendations.html>