An Overview of FinCEN's Customer Due Diligence Rule

Tina Bottaro, Risk Specialist
Supervision Regulation & Credit

Federal Reserve Bank of Philadelphia

Disclaimer

- The information presented are the views of the presenter and not the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

Background

- The U.S. has been criticized for not having a beneficial ownership rule.
  - The Financial Action Task Force (FATF) evaluates countries based on their Anti-Money Laundering (AML) programs. The U.S. has been criticized for being behind the international community in creating more transparency in financial transactions.
  - Currently, financial institutions are not required to know the identity of beneficial owners, except as defined by the Foreign Account Tax Compliance Act and with respect to foreign correspondent accounts and private banking accounts as defined by the USA PATRIOT Act.
  - In 2016, FinCEN updated a ruling within the BSA guidelines to clarify and strengthen CDD requirements.

Summary

- The “Know Your Customer” (KYC) section of the Bank Secrecy Act (BSA) is changing; There are two points to the updated CDD rule:
  - to strengthen existing guidance, and
  - to establish the **beneficial ownership** rule
- The primary change to the BSA is **covered financial institutions** will now be required to know the identity of the individuals who own or control their **legal entity customers**
- Banks will need to comply by:
  - Identifying persons owning or controlling 25% or more of a legal entity
  - Identifying an individual who has substantial management authority at the legal entity
  - Monitoring and updating the **beneficial ownership** of a legal entity
- This important change to the BSA guidelines will:
  - Enhance financial transparency
  - Help safeguard financial systems against illicit use
- The Final Rule is effective July 2016 and Financial Institutions must comply ***by May 11, 2018***

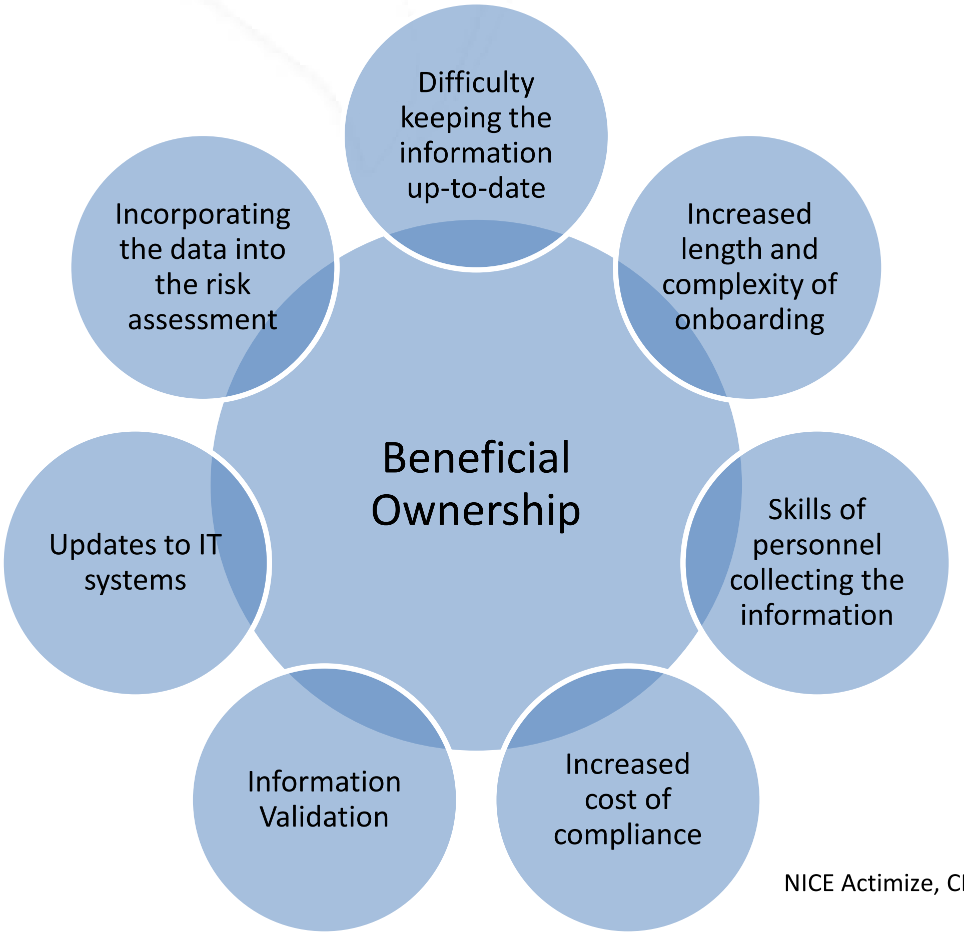
Why This Change is Important

- The change to the BSA guidelines will enhance financial transparency and help safeguard financial systems against illicit use.

- The key elements of CDD will:
    1. Identify and verify customer identity
    2. **Identify and verify the identity of beneficial owners of legal entity customers**
    3. Understand customer relationships
    4. Conduct risk-based ongoing monitoring to maintain and update customer information and identify and report suspicious activities

- **Only the second CDD element is new!**

Challenges to Implementation



NICE Actimize, CDD Marketing Survey Results (2016)

Benefits to the Industry

- Decrease the estimated $300 billion in illicit proceeds that are generated annually in the United States due to financial crimes
  - CDD rule would need to reduce the estimated annual flow of illicit proceeds by only 0.45 percent (in each year of 2016-2025) in order to justify the costs the rule would impose over a ten-year period
- Improve financial institution management’s ability to assess risk and understand customer relationships
- Help to facilitate compliance with required list-based searches
- Enhance financial transparency and help to safeguard the global financial system against illicit use

Bank Compliance Expectations

- Banks should prepare by:
  - Developing and implementing an action plan, with timelines, to manage the regulatory change at the company
    - Engage all key constituents — such as the board of directors, legal staff, information technology staff, and third-party service providers
  - Developing risk-based internal policies and procedures for obtaining and updating beneficial ownership information
    - Updating CDD forms and instructions
    - Building customer risk profiles
  - Communicating new policies and procedures
  - Planning and executing appropriate personnel training
  - Updating record retention policies
  - Communicating with affected customers in advance to minimize disruption in the customer service experience

Lending Considerations

- Borrowers are frequently reluctant to cooperate with a bank lender in a manner that is outside of the scope of their specific contractual undertakings.
  - To mitigate risks, banks should:
    - Consider amending its application and loan documentation to incorporate appropriate covenants that address the obligation of a legal entity to fully cooperate with a bank's CDD program
    - Draft covenants regarding ongoing reviews, and place an affirmative obligation on a legal entity to respond to a request by a bank to update or recertify beneficial ownership information
    - Consider educating their borrowers and legal counsel that transparency in ownership should now be expected

About Today's Presenters

Tina Bottaro is a Specialist at the Federal Reserve Bank of Philadelphia who provides risk analysis and surveillance for large banks. Her work involves analyzing trends and emerging issues within large banks to enable risk focused supervision. Her areas of expertise include regulatory reporting, credit risk, data analysis, and the allowance for loan losses. Prior to working for the Federal Reserve, Tina spent 28 years working for large banking organizations such as American Express, Deutsche Bank, and BB&T. Throughout her career, Tina has analyzed many new and revised regulatory requirements for impacts and has implemented plans for change management. Tina believes that service to others is a key element of leadership, and in her spare time, she volunteers with many organizations that mentor youth in the Philadelphia and New Jersey areas. Tina has a bachelor's degree in accounting from Rowan University.

Adina Himes is a Supervising Examiner at the Federal Reserve Bank of Philadelphia and is currently a BSA/AML risk specialist for large banks. Throughout her 17 year career with the Federal Reserve System, Adina has been a manager responsible for community bank supervision, and as an examiner, has conducted numerous BSA/AML examinations at financial institutions ranging between $70 million and $1.9 trillion in assets. When schedule permits, she instructs the Federal Financial Institution Examination Council's AML Workshop for examiners, and she has written informational BSA/AML articles that have been published by numerous banking magazines and websites. Adina has a bachelor's degree in business administration from Northeastern University, Boston, Massachusetts.