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Beyond the 5th Pillar: Operationalizing Beneficial Ownership Requirements

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Key Objectives

- Best Practices:
 - ✓ A Tactical Approach to Compliance
 - ✓ Engagement at all levels
 - ✓ Role of Software
 - ✓ Audit Engagement

Customer Due Diligence : The 5th Pillar

“...covered financial institutions must identify and verify the identity of the beneficial owners of all legal entity customers at the time a new account is opened. The financial institution may comply either by obtaining the required information on a standard certification form (Certification Form (Appendix A)) or by any other means that comply with the substantive requirements of this obligation. The financial institution may rely on the beneficial ownership information supplied by the customer, provided that it has no knowledge of facts that would reasonably call into question the reliability of the information.”

<https://www.federalregister.gov/d/2016-10567>

- Codifies Customer Due Diligence Requirements as Fifth Pillar of BSA
- New requirement to identify and verify the owners of legal entities
- Requires Risk-Based approach to maintaining and updating customer information
- Compliance Required by May 11, 2018



Core Elements of Customer Due Diligence

1. Customer Identification and Verification
2. Beneficial Ownership Identification and Verification
3. Understanding the Nature and Purpose of Customer Relationships
4. Ongoing Monitoring and Risk-Based Updating of Customer Information

Core Elements of Beneficial Ownership

Ownership Prong

- Each Natural Person with ownership of 25% or more equity stake in the company
- May include up to 4 separate natural persons
- Instances where no natural person owns 25% or more

Control Prong

- One individual with management-level control of the company
- Required regardless of ownership prong
- May be an individual already listed in Ownership Prong



Early Executive Engagement

- Budget Considerations
- Support from Business Units
- Project Management
- Changes to Policies, Procedures, and Processes
- IT Considerations
- Data Validation
- Training Needs
- Role of Audit

Getting Started

- Where is your financial institution (FI) now ?
- Create a business case
- Involve executive management and possibly Board of Directors
- Determine what business lines may be affected / involved
- Work with vendors
 - ✓ AML Vendor and Core / Onboarding system / Customer Due Diligence
- Create a working group / project team
- Ongoing status meetings and updates
 - ✓ Document key decision points

Creating a Business Case

Develop the Business Case:

- What is the opportunity or problem this project addresses
- What are the objectives / goals for the project
- Map out the time line
- What are some assumptions and constraints that may impact a successful implantation. *Example: Vendor*

Creating a business case

- State the risk and mitigation factors:
 - ✓ **Complexity Factors**: Process changes for account opening and ongoing monitoring will be required for all customer facing business lines for the bank.
 - ✓ **Risk Factors**: Failure to comply could result in regulatory penalties and possible monetary fines.
 - ✓ **Mitigation Techniques**: Deep engagement with the business and training. Enhance quality control procedures to ensure teammates are in compliance with the new regulation.
- Cost / Benefit
 - ✓ Cost of the project (upgrades to system)
 - ✓ Any benefits to the financial institution
- Any alternatives that can be done
 - ✓ 3rd party assistance

Working with Vendors

- Know what systems will be affected
 - ✓ Onboarding
 - ✓ Core
 - ✓ AML
 - ✓ Others?
- Be involved with the vendor
- Ask questions
- Obtain frequent updates

What does a Financial Institution need?

- The certification form or equivalent - LOCKED until 5 years after closure (Snap Shot in Time).
- 5 forms, 1 per each person\entity with the originals “locked”, and a layering of forms for when a commercial entity is owner by another commercial entity.
- A systematic approach to identify when an “event” has occurred requiring EDD again.
- The ability to update the information when changes are triggered by an event.
 - “What changed? Who? Why? Where? - And, find all related entities in the Bank for review.
- Ability to ID when Information is missing.
- Ability to add a risk score and percentage of ownership for each form.

What does a Financial Institution need?

- Audit trail on who created the record and when
- Ability to attach docs and a way to inform personnel; What docs are & are not required.
- Ability to filter all BO data against OFAC, PEP, etc. (based on policies).
- Audit trail and ALL dispositioning functionality for OFAC \ list screening
- Ability to feed the data to a CIP service i.e. Lexus Nexus, E-Funds, Experian...
- Ability to link TINs across the entire customer base at all levels.
- The ability aggregate “cash” on common TINs Acct, signers, BO’s.
- Ability to ID duplicate Addresses
- Capturing; Entity Type, Where ID was issued, ID Expiration, Citizenship, NRA, PEP, Phone numbers, Email addresses, Nationality

3 Models for addressing the challenges of Beneficial Ownership\CDD\EDD

- Automated AML System
- Core Banking Platform
- Homegrown System

Using an Automated AML System*

Everything in one place:

- Certification form LOCKED until 5 years after closure (Snap Shot in Time “Unchanged”)
- Ability to ID when information is missing (this has continued to be an issue in CIP)
- Original “snap shot” & “ongoing EDD” side by side
- Ability to attach documents (*not all Core Banking Systems can do this*)
- Ability to “highlight information” (*right click*) to Google it, Copy & Paste
- Ability to add a risk score and assign a “Tag” for unique risk attributes
- Detection and Alerting of a “Triggering Event” by monitoring for deviations against the “expected activity” on a customer’s EDD record. Next, (*double click*) and you have a new EDD form in a second and the audit log is automatically created.
- Audit logs are BSA\KYC\OFAC Oriented (*easier to document compliance for examiners*)
- Ability to schedule and automate on-going CDD\EDD reviews
- Transaction aggregation by TIN is automated (*across the entire customer base at all levels*).
- Ability to ID duplicate addresses
- OFAC filtering, dispositioning, record keeping and documentation reports and logs.

*Is your AML vendor providing a solution?



On your Core System

Core Hierarchy:

- CIF -Customer Information File
- Customer Detail Records
- Account Records

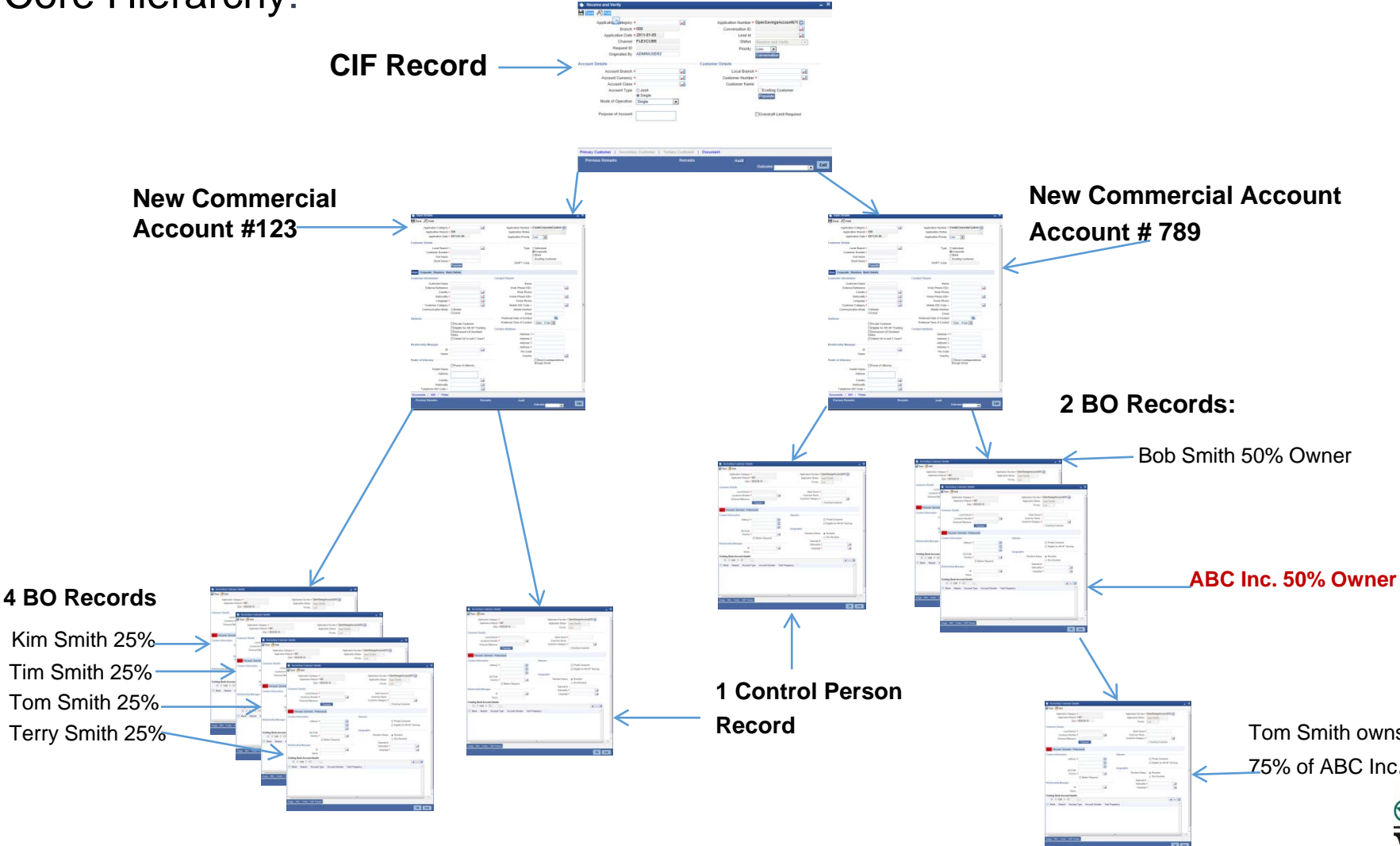
Requires at least 2 different system applications:

- Core
- Storage System (snapshot)

The screenshot displays a software interface for managing customer details. It features a top navigation bar with 'Save' and 'Hold' options. The main area is divided into several sections: 'Application' (with fields for Category, Branch, Date, Number, Status, and Priority), 'Customer Details' (with fields for Local Branch, Customer Number, External Reference, Short Name, Customer Name, and Category), and a tabbed interface for 'Personal', 'Domestic', and 'Professional' information. The 'Personal' tab is selected, showing 'Contact Information' (Address, Zip Code, Country, Mailers Required), 'Statuses' (Private Customer, Eligible for AR-AP Tracking), and 'Geographic' (Resident Status: Resident/Non Resident, National Id, Nationality, Language). Below this is a 'Relationship Manager' section with 'ID' and 'Name' fields. At the bottom, there is an 'Existing Bank Account Details' table with columns for Bank, Branch, Account Type, Account Number, and Visit Frequency. The table is currently empty. The window has 'Ok' and 'Exit' buttons at the bottom right.

On a Core Banking System

Core Hierarchy:



Preparing for the changes

- Prior to the effective date of May 11, 2018 expect an increase focus by the regulators regarding the banks implementation plan.
- The implementation plan should address the efforts taken by the bank to comply with the requirements and should include areas such as:
 - ✓ Effective controls in systems, processes, policies, and training programs.

Audit

- An audit of beneficial ownership will involve a representative review of relevant risks based on the bank's customers.
- The relevant risk will depend on the nature of the business relations, delivery channels, and transactions involved.

Role of 3rd line of defense

- Understanding the nature of the client's business and ensuring the activity is commensurate with the nature and purpose of client's business is key to complying with the 5th pillar.

Key Take Away(s)

- Be prepared and be organized i.e. Start Now!
- Take an Enterprise Approach - Executive Engagement is Critical!
- Engage all impacted lines of business