



The nonprofit
business leaders'
network.

Customer Due Diligence, Beneficial Ownership and Other Things:

Understanding this major change to US Anti-Money Laundering
Obligations and its impact on the business and NPO
communities

JOHN J. BYRNE, ESQ., CAMS

VICE CHAIRMAN

AML RIGHTSOURCE



Why a CDD Rule?

Concerns about financial transparency date back to at least the 1990s

U.S. failed to achieve a “fully compliant” rating from the Financial Action Task Force at 2006 Mutual Evaluation

U.S. also rated “partially compliant” at 2016 FATF ME

Concerns exacerbated by Panama Papers case

In response, FinCEN/Treasury initiated rulemaking process in 2012, with final rule issued in 2016

FinCEN on May 11th

The Financial Crimes Enforcement Network (“FinCEN”) reminds financial institutions and their customers that the final rule, “Customer Due Diligence Requirements for Financial Institutions” (the CDD Rule) becomes effective today.

FinCEN issued the CDD Rule, which amends Bank Secrecy Act regulations, to improve financial transparency and prevent criminals and terrorists from misusing companies to disguise their illicit activities and launder their ill-gotten gains. The CDD rule clarifies and strengthens customer due diligence requirements for U.S. banks, mutual funds brokers or dealers in securities, futures commission merchants, and introducing brokers in commodities and adds a new requirement for these covered financial institutions to identify and verify the identity the natural persons (known as beneficial owners) of legal entity customers who own, control, and profit from companies when those companies open accounts.

The CDD Rule has four core requirements. It requires covered financial institutions to establish and maintain written policies and procedures that are reasonably designed to (1) identify and verify the identity of customers; (2) identify and verify the identity of the beneficial owners of companies opening accounts; (3) understand the nature and purpose of customer relationships to develop customer risk profiles; and (4) conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

With respect to the new requirement to obtain beneficial ownership information, financial institutions will have to identify and verify the identity of any individual who owns 25 percent or more of a legal entity, and an individual who controls the legal entity.

New FFIEC Exam Guidelines and how a bank's response will impact you

“the bank may consider obtaining, at account opening (and throughout the relationship), more customer information in order to understand the nature and purpose of the customer relationship, such as:

- Source of funds and wealth.
- Occupation or type of business (of customer or other individuals with ownership or control over the account).
- Financial statements for business customers.
- Location where the business customer is organized and where they maintain their principal place of business.
- Proximity of the customer's residence, place of employment, or place of business to the bank.
- Description of the business customer's primary trade area, whether transactions are expected to be domestic or international, and the expected volumes of such transactions.
- Description of the business operations, such as total sales, the volume of currency transactions, and information about major customers and suppliers.”

Beneficial Ownership

Basic requirement: all covered institutions must establish and maintain written procedures that are reasonably designed to identify and verify beneficial owners of legal entity customers and to include such procedures in their AML program

Elements of Beneficial Owner

Control Prong: A single individual with significant responsibility to control, manage, or direct a legal entity customer, including:

- An executive officer or senior manager, e.g., CEO, CFO, etc.
- Any other individual who performs similar functions

Ownership Prong: Each individual who directly or indirectly owns 25% or more of the equity interests of a legal entity customer

- Some entity types not subject to ownership prong, only control
- If a trust owns directly or indirectly, 25% or more of the equity interests of a legal entity customer, the beneficial owner is the trustee

The number of beneficial owners may vary between 1 and 5

- 1 person to meet the “control prong” and up to 4 based on percent of ownership (ownership prong)

PWC Study on CDD (Excerpt)

The 25% collection threshold is being viewed as a floor and not a ceiling. The CDD Rule requires that FIs identify individuals that directly or indirectly own 25% or more of equity interest of a legal entity customer. However, the majority of FIs surveyed indicated that, for certain higher risk customers, they are planning to drill below the 25% threshold. 52% of respondents will apply a 10% threshold for higher-risk customers, and 6% of the survey participants indicated that they are currently utilizing threshold levels below 25% for all customers, regardless of risk (e.g., 20% or 10%).

https://www.pwc.com/us/en/financial-services/financial-crimes/publications/assets/pwc-financial-crimes-cdd-report.pdf?elq_mid=9963&elq_cid=176901

Identification

The institution's CDD procedures must enable it to identify the beneficial owners of each legal entity customer at the time a new account is opened unless the account is exempted:

- May use certification form or obtain the requisite information by other means provided the individual certifies the accuracy of the information

Verification

Must also verify the identity of each beneficial owner using risk-based procedures to the extent reasonable and practicable

- At a minimum these procedures must contain the elements required under the CIP rule
- May use photocopies for documentary verification
- May rely on representations made by the customer provided institution has no knowledge of facts that call into question the reliability of such information

Recordkeeping

Institutions must keep a record of the identification information for five years after the account is closed

Institutions must keep a description of the document relied on for verification for five years after the record is made

Reliance

May rely on the performance of another institution provided that such reliance is reasonable, the other institution is subject to a program rule requirement, and the other institution enters into a contract certifying annually that it has complied with its AML program

Appropriate Risk-Based CDD Procedures

Must include but not be limited to:

- Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile
- Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information, including beneficial ownership information

Issues to Ponder

Supervisory expectations

- 25% requirement or lower?
- Multiple levels of ownership of legal entities

Trusts

Exemptions — customer level and account level

Handling practical aspects of multiple account openings

Leveraging prior CIP

Inability to verify identity of beneficial owners

Defining “trigger” event for updates to customer information

Utilizing CDD information for other processes (OFAC, 314(a))

What to do

Form project team

Conduct gap analysis

Develop action plan addressing changes to policies and procedures, training, vendor management, IT, etc.

Obtain senior management buy-in and funding

Document all major decisions

Consider customer experience

Training

Bank should provide training to branch and lending personnel, central operations, BSA department, and any business line that can establish or update a customer relationship. The training should address:

- Purpose and requirements of the rule
- Definition of beneficial owner
- CIP/CDD/beneficial owner process
- Escalation process for incomplete or inaccurate information
- OFAC issues
- CDD requirements
- Triggering events
- Account closure
- Revised in-person and online onboarding
- Changes to existing policies, procedures, and risk assessment

A Sample of a Bank's Public FAQs (Excerpts)

Who is a beneficial owner?

A: The CDD rule defines beneficial owner as each of the following:

..each individual, if any, who, directly or indirectly, owns 25 percent or more of the equity interests of a legal entity customer (i.e., the ownership prong);

AND

..a single individual with significant responsibility to control, manage or direct the legal entity customer, including an executive officer or senior manager (e.g., a chief executive officer, chief financial officer, chief operating officer, managing member, general partner, president, vice president or treasurer); or any other individual who regularly performs similar functions (i.e., the control prong). This list of positions is illustrative, not exclusive, as there is significant diversity in how legal entities are structured.

Under this definition, a legal entity will have a total of between one and five beneficial owners (i.e., one person under the control prong and zero to four persons under the ownership prong).

More FAQ Excerpts

Question 6: Is Bank X required to collect beneficial ownership information for existing legal entity clients?

A: Yes. If the existing legal entity client opens a new account on or after April 2, 2018, the information will be collected. Bank X may also request that a Certification Form be completed or updated if there is a change in the beneficial ownership of a business.

Question 7: What if Bank X does not have the required beneficial ownership information at account opening?

A: Without this information, an account cannot be opened.

Question 8: Does Bank X need to obtain beneficial ownership information again if a legal entity client opens another account?

A: Yes. However, Bank X may rely on previously obtained information under certain circumstances.

Question 9: Is Bank X required to obtain information directly from the beneficial owners of legal entity customers?

A: No. Information about the beneficial owners of a legal entity will be obtained from the individual seeking to open a new account at Bank X on behalf of the legal entity client. This individual could, but would not necessarily, be a beneficial owner.

The individual seeking to open a new account at Bank X on behalf of the legal entity client must certify that the information he/she provides on the Certification Form is accurate.

Vendor Management

Vendors should be updating products to address CDD rule changes

If bank is relying on electronic vendor or third-party verification, an element of the bank's vendor management process should include adequate controls, reviewing procedures for vendor relationships, and establishing a quality control function to validate the verification

Technology

Identify and implement changes to ensure that IT systems are incorporating beneficial ownership information into onboarding, recordkeeping, monitoring, and reporting systems

Develop a technology plan addressing key stakeholders, measurable goals and deadlines, testing, approval, and rollout

CDD Update

The release of FinCEN's FAQs

https://www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf

FBA's Examination Procedures

Congressional hearings and possible changes?

FinCEN FAQ Key Points

Question 2: Interaction of the beneficial ownership threshold with other AML program obligations Are there circumstances where covered financial institutions should consider collecting beneficial ownership information at a lower equity interest threshold under the anti-money laundering (AML) program rules with regard to certain customers?

A. There may be circumstances where a financial institution may determine that collection and verification of beneficial ownership information at a lower threshold may be warranted, based on the financial institution's own assessment of its risk relating to its customer.

Collection of beneficial ownership information for direct and indirect owners: Legal entity customers with complex ownership structures

When a legal entity is identified as owning 25 percent or more of a legal entity customer that is opening an account, is it necessary for a covered financial institution to request beneficial ownership information on the legal entity identified as an owner?

Under the Rule's beneficial ownership identification requirement, a covered institution must collect, from its legal entity customers, information about any individual(s) that are the beneficial owner(s) (unless the entity is excluded or the account is exempted). Therefore, covered financial institutions must obtain from their legal entity customers the identities of individuals who satisfy the definition, either directly or indirectly through multiple corporate structures.

A covered financial need not independently investigate the legal entity customer's ownership structure and may accept and reasonably rely on the information regarding the status of beneficial owners presented to the financial institution by the legal entity customer's representative, provided that the institution has no knowledge of facts that would reasonably call into question the reliability of the information.

Other FAQ Issues

Exclusions

Monitoring

New accounts

Triggering events

Customer risk profiles

For More Information

John J. Byrne, Esq., CAMS

Vice Chairman



C 703-282-4954

jbyrne@amlrightsourc.com

[john.byrne90@yahoo.com \(personal\)](mailto:john.byrne90@yahoo.com)