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About Navigant

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FINCEN CUSTOMER DUE DILIGENCE REQUIREMENTS FOR FINANCIAL INSTITUTIONS: FINAL RULE

I. INTRODUCTION

On May 11, 2016, the Financial Crimes Enforcement Network ("FinCEN"), Treasury, released the long awaited Customer Due Diligence ("CDD") Requirements for Financial Institutions Final Rule ("Final Rule") that formally requires covered financial institutions to collect beneficial ownership information from customers at account opening and to ensure the information is accurate on an ongoing basis.¹ FinCEN has adopted the Final Rule because it has determined that more explicit rules for covered financial institutions² are needed to clarify and codify CDD within the Bank Secrecy Act ("BSA") regime. The final rule is effective July 11, 2016. Covered financial institutions must be in compliance by May 11, 2018 (the "Applicability Date").³

A. Key Elements of the Final Rule

FinCEN released the Final Rule in two key provisions, first introducing a requirement to obtain and verify beneficial ownership information for legal entity customers; and second, codifying the existing expectation that financial institutions establish a customer risk profile and conduct ongoing monitoring against that profile.

1. Beneficial ownership identification and verification

The Final Rule contains a new requirement to establish and maintain written procedures to identify—and on a risk-based approach—verify the identity of, beneficial owners of legal entity customers. FinCEN guidance allows a financial institution to rely on the beneficial ownership identity information supplied by the customer, provided that it has no knowledge of facts that would reasonably call into question the reliability of the information.

FinCEN points out that the identification and verification procedures for beneficial owners are similar to those for individual customers under

1. Financial Crimes Enforcement Network, Treasury, 31 CFR Parts 1010, 1020, 1024, and 1026, RIN 1506-AB25, *Customer Due Diligence Requirements for Financial Institutions*, Action: Final rules. Available at: <http://federalregister.gov/a/2016-10567>, and on FDsys.gov

2. Defined to include federally regulated banks, brokers and dealers in securities, mutual funds, and future commission merchants and introducing brokers in commodities.

3. *Ibid* At 29398

a financial institution's customer identification program ("CIP")⁴. Like the CIP rule, the agency has provided both specific exemptions from the rule, and exclusions to the definition of "legal entity customer," and financial institutions are permitted to rely on another financial institution to execute the requirements. Critically, an account is a "new account" only if it is opened at the covered financial institution on or after the rule's Applicability Date.⁵ Consistent with previous rulemaking, the Final Rule requires retention of beneficial ownership records for five (5) years.⁶

a. What is a Beneficial Owner?⁷

FinCEN determined that the minimum threshold for equity holdings that constitutes ownership is 25 percent, whether directly or indirectly held. The proposed 25 percent threshold is consistent with that of many jurisdictions (including European Union ("EU") member states) and with Financial Actions Task Force ("FATF") standards. FinCEN believes that a 25 percent threshold strikes the appropriate balance between the benefit of identifying key natural persons who have substantial ownership interests in the legal entity and the costs associated with implementing this information collection requirement. FinCEN addressed the particular nuances of trusts in the Final Rule, by in such cases that a trust is the 25 percent beneficial owner of a legal entity, defining the beneficial owner as the trustee.

In addition to those individuals with 25 percent equity interest, the Final Rule also includes within the definition of "beneficial owner" individuals with significant responsibility to control, manage or direct the legal entity customer, such as a Chief Executive Officer, Chief Financial Officer, General Partner, Managing Member or another individual who regularly performs similar functions. The rule specifically references control over the customer not the account. Financial institutions should also determine as appropriate that it

understands who is in responsible for directing the activity in the account.

b. FinCEN's Certification Form⁸

The Final Rule requires that a person opening a new account on behalf of a legal entity certify the information presented to the financial institution. FinCEN provides a form as an appendix to the rule for financial institutions to use to collect such beneficial owner information, including name, date of birth, address and a Social Security Number for US persons or a government issued identification number such as a passport number for non-US persons.

Although the form is not mandated by the rule, the information and certification therein is. The identification of beneficial owners is required at the time a new account is opened.

2. Anti-Money Laundering Program Amendments⁹

FinCEN also amended rules relating specifically to banks, brokers or dealers in securities, mutual funds and futures commission merchants and introducing brokers in commodities. The amendments include a requirement to develop risk-based procedures to conduct ongoing due diligence to develop a customer risk profile and to conduct ongoing monitoring to identify and report suspicious activity and update customer information. The revisions also reiterate existing requirements to implement and maintain an anti-money laundering program that includes training, independent testing, a designated individual responsible for compliance and a system of internal controls to ensure compliance with the BSA and relevant regulatory or SRO rules.

a. Customer Risk Profile

In drafting the Final Rule, FinCEN codified the implicit requirement for a covered financial institution to understand its customer's anticipated activity, required to comply with existing suspicious activity reporting ("SAR") requirements, specifically the requirement to

4. 31 CFR 1020.220, 1023.220, 1024.220, 1026.220

5. Ibid At 29398

6. Ibid At 29453

7. Ibid At 29451-29452

8. Ibid At 29451, 29454-29455

9. Ibid At 29457-29458

report activity with no business or apparent lawful purpose or that which is not the sort in which the customer would be expected to engage. In addition to profiling against industry typologies, in order to satisfy its existing reporting obligations, a financial institution must also understand what is behaviorally normal or usual for a customer to understand what is unusual and therefore potentially suspicious. To ensure financial institutions can satisfy the requirement, the amendments require covered financial institutions to understand the nature and purpose of the customer's relationship to develop a customer risk profile indicating. Examples include the products and services used by the customer and for what purpose, basic facts about the customer's annual income or net worth, domicile, principal occupation or business, whether the customer is operating through a financial intermediary, and for existing customers, the history of activity.

b. Ongoing Monitoring, and Maintaining and Updating customer information

FinCEN clarifies and codifies that financial institutions are expected to conduct ongoing monitoring to identify and report suspicious activity—an expectation that was previously only implied by the SAR reporting requirements. Additionally, FinCEN clarifies in the Final Rule that when a financial institution detects information (including a change in beneficial ownership information) about the customer in the course of normal monitoring that is relevant to assessing or reevaluating the risk posed by the customer, it must update the customer information, including beneficial ownership information. Covered financial institutions are to take a risk-based approach to updating customer information, including beneficial ownership information, however FinCEN clarifies that this requirement should be event driven and occur as a result of normal monitoring. The rule also highlights that this requirement is applicable to all legal entity customers, *including* those existing on the Applicability Date.

II. WHY IMPOSE A CDD RULE?

The Final Rule is intended to strengthen CDD within the BSA regime, which in turn will enhance financial transparency and help to safeguard the financial system against illicit use, from terrorist financing and sanctions evasion to more traditional financial crimes, including money laundering, fraud and tax evasion.

FinCEN aims to advance the purposes of the BSA by enhancing the availability of beneficial ownership information to law enforcement, federal functional regulators and self-regulatory organizations (“SROs”).¹⁰ Additionally, requiring all covered financial institutions to identify and verify the identities of beneficial owners in the same manner and pursuant to the same definition promotes consistency across the industry.

III. WHAT THIS MEANS TO YOU

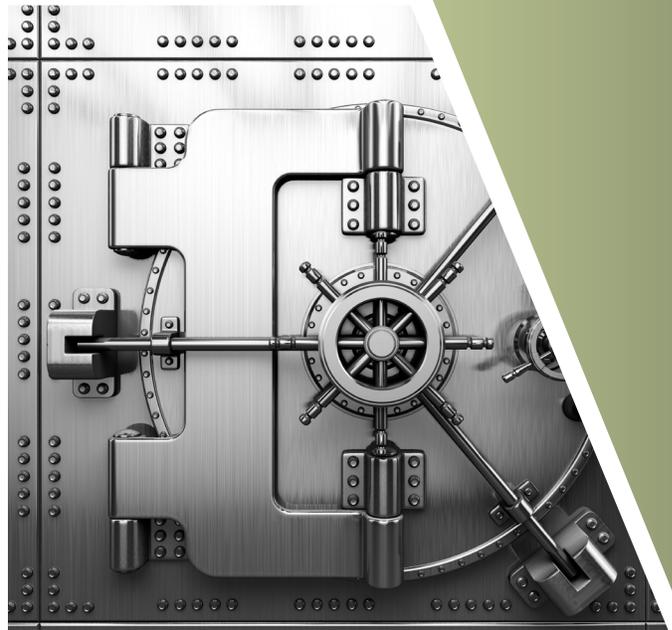
Time is short and the changes are significant. To ensure adherence to the final CDD rule, compliance officers will need to evaluate, and where applicable, enhance their financial institution's AML program policies, procedures and controls impacted by the Final Rule, including changing account onboarding processes and potentially re-engineering risk assessments. Compliance officers will need to partner with technology to review existing customer profile, monitoring and record retention systems. This will help determine whether existing infrastructure can accommodate the new requirements and any cascading effects on the financial institution's other processes. Financial institutions should also identify areas to leverage within the firm to access information if such information is not already integrated.

FinCEN expects that with the adoption of the Final Rule, SARs filed by financial institutions will be increasingly likely to include beneficial ownership information for legal entity accounts. Any increase in the number of SARs filed under the Final Rule would likely be offset by the capacity of newly collected beneficial ownership data to remove some flagged transactions from suspicion. Both account opening staff and investigators will need to evaluate the impact of the Final Rule.

¹⁰. Ibid At 29399-293400

IV. WHAT YOU CAN DO RIGHT NOW

- A. Compliance Officers should socialize the new rule with senior compliance and business management, and include those responsible for technology planning and budgeting. Consider providing an update to sales or similar staff which may be impacted and answering client questions.
- B. A gap analysis should be prepared to evaluate the financial institution's current program against the proposed rule.
- C. Based on the gap analysis, prepare a formal action plan for implementation of the changes that will be necessary, and identify those changes which require the most lead time. Determine which governance forum or committee in your organization should be responsible for overseeing and sponsoring the implementation and determine how and when updates should occur.
- D. Evaluate changes in technology that might be required at both on-boarding and transaction monitoring. Create a timeline to ensure critical path actions are identified and scoped early.
- E. Identify which high-risk customers for whom you may want to obtain beneficial ownership information even in cases where it is not technically required by the rule.
- F. Identify any sources of customer information which may be stored in other parts of the organization and can be leveraged to create a customer risk profile.



V. HOW NAVIGANT CAN HELP

Navigant's team of experts have the experience to assist financial institutions in implementing changes and revisions to their existing policies, procedures and controls. Navigant can provide your institution with highly skilled resources for the short-term implementation of these regulatory changes until your financial institution has incorporated such changes as "business as usual."