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BSA – Customer Due Diligence / Beneficial Owner Rule

On May 11, 2016, the Financial Crimes Enforcement Network (FinCEN) issued a new final rule under the Bank Secrecy Act (BSA) that clarifies and strengthens due diligence requirements. The rules include a new requirement to identify and verify the identity of beneficial owners of legal entity customers.

Updated Alert Date:	October 2, 2018
Status:	Effective July 11, 2016. Applicability Date: Covered financial institutions must comply with these rules by May 11, 2018.
Links:	Final Rule - 05/11/2016 FinCEN FAQs - 07/19/2016 Correcting Amendments - 09/28/2017 FinCEN FAQs - 04/03/2018 FinCEN Ruling FIN-2018-R003 - 09/07/2018

Covered financial institutions are subject to rules under the BSA that require a written Customer Identification Program (CIP). Prior to this new rule, institutions were not required to know the identity of the individuals who own or control their legal entity customers. This “loop hole” enables criminals to access the financial system anonymously. In order to address this weakness, FinCEN has strengthened the customer due diligence requirements with this final rule, which requires the identification and verification of beneficial owners of legal entity customers. Besides assisting law enforcement in investigations, this rule is also intended to help prevent evasion of targeted financial sanctions, improve the ability of institutions to assess risk and advance U.S. compliance with international standards.

After the final rule was issued, FinCEN released some frequently asked questions, which are linked above. In September 2017, FinCEN published correcting amendments to the rule, also linked above. The corrections include the following adjustments:

- Includes technical corrections to the Certification Form, located in Appendix A, and
- Adds a paragraph (to 31 CFR 1024.210(b)) that was inadvertently omitted. The paragraph reinserts the training element for AML program requirements for mutual funds.

In April, 2018, FinCEN published a second set of FAQs. These FAQs provide further clarification on various aspects of the rule. For example, the FAQs include discussion of the collection of beneficial ownership information for product and service renewals, and also provides additional clarity regarding this rule and its impact on CTR reporting. See the linked FAQs included above.

In September, 2018, FinCEN issued ruling FIN-2018-R003, that granted exceptive relief from the identification and verification of beneficial owner provisions for certain activities. Prior to this ruling, the exceptive relief for certain products and services that automatically roll over or renew was temporary. While the relief, now made final, does not apply to the initial opening of such accounts, it does apply to the following that occur on or after May 11, 2018:

- A rollover of a certificate of deposit;
- A renewal, modification, or extension of a loan that does not require underwriting review and approval;
- A renewal, modification, or extension of a commercial line of credit or credit card account that does not require underwriting review and approval; and
- A renewal of a safe deposit box rental.

Who is a “Legal Entity Customer?”

A “legal entity customer” means a corporation, LLC, or other entity that is created by the filing of a public document with the Secretary of State or similar agency, a general partnership and other similar entity that opens an account. The rule contains various exemptions, which include but are not limited to regulated financial institutions, SEC-registered investment companies or advisors, bank holding companies, and state-regulated insurance companies.

FinCEN has provided the following FAQ that addresses the inclusion of trusts within the definition of legal entity customer:

Q: Are trusts included in the definition of legal entity customer?

A: No. The definition of legal entity customers only includes statutory trusts created by a filing with the Secretary of State or similar office. Otherwise, it does not include trusts. This is because a trust is a contractual arrangement between the person who provides the funds or other assets and specifies the terms (i.e., the grantor/settlor) and the person with control over the assets (i.e., the trustee), for the benefit of those named in the trust deed (i.e., the beneficiaries). Formation of a trust does not generally require any action by the state.

The CDD Rule does not supersede existing obligations and practices regarding trusts generally. The preamble to each of the CIP rules notes that, while financial institutions are not required to look through a trust to its beneficiaries, they “may need to take additional steps to verify the identity of a customer that is not an individual, such as obtaining information about persons with control over the account.” We understand that where trusts are direct customers of financial institutions, financial institutions generally also identify and verify the identity of trustees, because trustees will necessarily be signatories on trust accounts. Furthermore, under supervisory guidance for banks, “in certain circumstances involving revocable trusts, the bank may need to gather information about the settlor, grantor, trustee, or other persons with the authority to direct the trustee, and who thus have authority or control over the account, in order to establish the true identity of the customer.” (footnotes removed)

Who is a “Beneficial Owner?”

As referenced above, this new rule will require the identification of certain owners of legal entity customers, referred to as “beneficial owners.” The definition of “beneficial owner” is delivered in two prongs: an **ownership prong** and a **control prong**. More specifically, a beneficial owner means each of the following:

- Each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25% or more of the equity interests of a legal entity customer; * and
- A single individual with significant responsibility to control, manage, or direct a legal entity customer, including, for example, an executive officer or senior manager such as a President or Vice President or any other individual who regularly performs similar functions.

* Beneficial owners identified under the **ownership prong** could be as few as zero and as many as four individuals.

Illustrative Examples – Legal Entities and Beneficial Owners

<p>Legal Entity – Mom & Pop, LLC <i>Mr. and Mrs. Smith each hold a 50% interest. Mrs. Smith is President and Mr. Smith is Vice President.</i></p>	<p>Ownership Prong – Mr. and Mrs. Smith Control Prong – This individual could either be Mr. or Mrs. Smith, or a third person who otherwise satisfies the definition.</p>
<p>Legal Entity – Acme, Inc. <i>John Roe holds a 35% interest and no other person holds a 25% or greater interest. Jane Doe is President and CEO.</i></p>	<p>Ownership Prong – John Roe Control Prong – This individual could be Jane Doe or any other person who otherwise satisfies the definition.</p>
<p>Legal Entity – Quentin, Inc. <i>Owned by 5 siblings, each of whom holds a 20% stake. Benton Quentin, the eldest sibling, is President and the only individual at Quentin, Inc. with significant management responsibility.</i></p>	<p>Ownership Prong – n/a Control Prong – Benton Quentin</p>

What Does an Institution Need to Do?

Covered institutions must establish and maintain written procedures reasonably designed to identify and verify beneficial owners and to include such procedures in their anti-money laundering program. This includes identifying the beneficial owner(s) of each legal entity customer at the time a new account is opened (unless exempted).

First, while the new rule includes a certification form (Appendix A of the rule) that may be used in to aid in the identification process, the form is **optional**. In lieu of using that form, institutions may obtain from the individual opening the account the information that is required by the form via another means, provided that the individual certifies that to the best of their knowledge the information is accurate.

Second, the institution must then verify the identity of each beneficial owner identified, according to risk-based procedures to the extent reasonable and practicable. At a minimum, these procedures must contain the elements required for verifying the identity of consumers that are individuals under your CIP program.

Last, as addressed in the preamble to the final rule, FinCEN expects that an institution will generally be able to rely on the representation of the customer when identifying beneficial owners. FinCEN also emphasized that this obligation should be considered a “snapshot,” not a continuous obligation. However, FinCEN does expect institutions to update this information “based on risk, generally triggered by a financial institution learning through its normal monitoring of facts relevant to assessing the risk posed by the customer.”

What Else Should an Institution Know?

Covered institutions must ensure that the information obtained in connection with this rule for beneficial owners is maintained as part of your recordkeeping requirements, for a period of 5 years after the date the account is closed. This is to include any identifying information obtained including the certification form, if obtained.

Two Last Issues... OFAC and CTRs

Within the preamble to the final rule, FinCEN made clear their expectations of using information obtained under this rule for other compliance purposes, including compliance with **Office of Foreign Assets Control (OFAC)** regulations.

With respect to aggregation of transactions for **Currency Transaction Reporting (CTR)** purposes, FinCEN also has expectations to apply existing procedures consistent with CTR regulations and applicable guidance. As included in the preamble: “Thus, while financial institutions should generally recognize the distinctness of the corporate form and not categorically impute the activities or transactions of a legal entity customer to a beneficial owner, they must aggregate multiple currency transactions if the financial institution has knowledge that these transactions are by or on behalf of any person and result in either cash in or cash out totaling more than \$10,000 during any one business day.” To clarify, while the collection of beneficial owner information does not modify existing aggregation requirements, the collection of beneficial ownership information may provide institutions with information they did not previously have, in order to determine when transactions are “by or on behalf” of the same person.

Recommendations for Next Steps

By May 11, 2018:

1. Review CIP-related policies and procedures and update for new requirements regarding beneficial owners.
2. Review Record Retention policy and update for information on beneficial owners.
3. Determine whether your process will involve use of the certification form included in the rule, or other means, that includes a certification of accuracy.
4. Ensure beneficial owner information is used as other information you gather regarding customers is used, including compliance with OFAC regulations and CTR aggregation requirements.
5. Train applicable staff on new policy and procedures.