

Client Alert

April 2018

Are You Ready for the New CDD Rule Coming May 11, 2018? FinCEN Issues New FAQs

In advance of the May 11, 2018, compliance deadline, FinCEN recently issued a new set of frequently asked questions (FAQs) to assist banks, broker-dealers, mutual funds and other “covered financial institutions”¹ in the implementation of the new customer due diligence (CDD) requirements (the CDD Rule). The new FAQs, which can be [found here](#), serve as interpretative guidance to the CDD Rule, which was first published by FinCEN on May 11, 2016, in a Final Rule² and codified in the Bank Secrecy Act (BSA). A previous set of FAQs on the CDD Rule was issued by FinCEN on July 19, 2016.³

Below is a summary of the interpretative guidance set forth in several of the new FAQs issued by FinCEN. The new FAQs emphasize the level of engagement that covered financial institutions are expected to have when it comes to their customers. Covered financial institutions should refer to the complete list of new FAQs which can be found at the link above.

Beneficial Ownership Information Requirements

- Implementing Stricter Policies and Procedures:
 - Covered financial institutions may choose to implement stricter written internal policies and procedures for the collection and verification of beneficial ownership information than the requirements prescribed by the CDD Rule.
 - In some cases, based on a customer’s risk assessment, a covered financial institution may find it warranted to collect and verify beneficial ownership information at a lower equity ownership threshold than the required 25 percent. *However*, more transparency in beneficial ownership is only one method of mitigating the specific risk posed by a customer, and the covered financial institution may find that other means of mitigating risk—such as enhanced monitoring or collecting other types of information from the legal entity customer (such as expected account activity)—are more useful and appropriate.
- Complex Ownership Structures: When requesting beneficial ownership information from a legal entity customer, covered financial institutions must collect information on the identity of any individuals who own 25 percent or more of the equity interests of the legal entity customer, whether they own that 25 percent *directly or indirectly* through multiple corporate structures.

¹ “Covered financial institutions” for purposes of the CDD Rule refers to: (i) banks; (ii) brokers or dealers in securities; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers in commodities.

² <https://www.fincen.gov/resources/statutes-regulations/federal-register-notices/customer-due-diligence-requirements>

³ <https://www.fincen.gov/resources/statutes-regulations/guidance/frequently-asked-questions-regarding-customer-due-diligence>

- Methods of Verifying Beneficial Ownership Information: When verifying the identity of beneficial owners, covered financial institutions should follow risk-based procedures that contain, at a minimum, the same elements as the institution's Customer Identification Program (CIP). *However*, the two procedures do not have to be identical; for example, a covered financial institution's beneficial ownership verification procedures may allow the institution to accept photocopies of a beneficial owner's driver's license to verify their identity, something which is not permissible under CIP requirements.
- Existing Customers as Beneficial Owners of New Legal Entity Customers: If an individual identified as a beneficial owner of a legal entity customer is an existing customer of the covered financial institution, the institution may rely on preexisting CIP information in its possession to verify the identity of the beneficial owner, *provided that* the preexisting CIP information is up-to-date and accurate, and the legal entity customer's representative certifies or confirms (verbally or in writing) the accuracy of the preexisting CIP information.
- Record Retention: Records that identify or verify beneficial ownership information must be retained for a period of five (5) years from the date the legal entity's account is closed or the date a record is made, depending on the nature and purpose of the record. For example, identifying information—such as the certification form (or equivalent) required by the CDD Rule—must be maintained for five (5) years *after the account is closed*, but a description of any document relied on for verification, any nondocumentary methods and the results of measures undertaken for verification must be retained for five (5) years *after the record is made*.
- Multiple Accounts Opened by a Legal Entity Customer: When a legal entity customer opens multiple accounts, the covered financial institution may rely on the information in that customer's existing certification form (if available) to fulfill the beneficial ownership requirement for subsequent accounts, *provided that* the customer certifies or confirms (verbally or in writing) that the information is up-to-date and accurate at the time each subsequent account is opened and the institution has no knowledge of facts that would reasonably call into question the reliability of such information.
- Financial Product or Service Renewals (Loans, CDs, etc.): Covered financial institutions must obtain certified beneficial ownership information from legal entity customers at *each* renewal of a financial product or service (e.g., loan or certificate of deposit renewal). *However*, to the extent that the legal entity customer and the financial service or product remain the same, the customer certifies or confirms that the previously obtained beneficial ownership information is accurate and up-to-date, and the institution has no knowledge of facts that would reasonably call into question the reliability of the information, the institution is not required to collect the beneficial ownership information again.
- Existing Accounts: Covered financial institutions are not required to conduct retroactive reviews to obtain beneficial ownership information from customers with accounts opened prior to May 11, 2018. *However*, covered financial institutions must obtain or update beneficial ownership information on existing accounts (opened before May 11, 2018) when the institution becomes aware of a possible change of beneficial ownership during the course of normal monitoring relevant to assessing or reassessing the risk posed by the customer.
- Updating Beneficial Ownership Information During Periodic Reviews: Absent specific risk-based concerns, covered financial institutions do not have an obligation to solicit or update beneficial ownership information as a matter of course during regular or periodic reviews. Periodic reviews are not by themselves a trigger to obtain or update beneficial ownership information. The obligation to obtain or update information is triggered when, in the course of normal monitoring, the financial institution becomes aware of information about a customer or an account, including a

possible change of beneficial ownership information, relevant to assessing or reassessing the customer's overall risk profile.

- Pooled Investment Vehicle Customers: Covered financial institutions are not required to look through a pooled investment vehicle to identify and verify the identity of any individuals who own 25 percent or more of its equity interests. *However*, covered financial institutions must collect beneficial ownership information for the pooled investment vehicle under the control prong to comply with the CDD Rule (i.e., an individual with significant responsibility to control, manage or direct the vehicle, such as a portfolio manager, commodity pool operator, commodity trading advisor or general partner of the vehicle).
- Trust Customers: If a trust owns directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, 25 percent or more of the equity interests of a legal entity customer, the beneficial owner for purposes of the ownership/equity prong is the trustee, regardless of whether the trustee is a natural person or a legal entity. *However*, a covered financial institution should collect identification information on the legal entity trustee as part of its CIP, consistent with the covered institution's risk assessment and the customer risk profile.
- US Publicly Traded Companies and Entities Listed on Foreign Exchanges: Companies that are publicly traded in the United States are excluded from the definition of "legal entity customer" and are not subject to the CCD Rule's beneficial ownership information requirements. A publicly traded company includes those companies (other than banks) whose common stock or analogous equity interests are listed on the New York Stock Exchange, the American Stock Exchange (currently known as NYSE American) or NASDAQ stock exchange, and also includes a US entity when at least 51 percent of its common stock is held by such a listed entity. *However*, companies listed on foreign exchanges are not excluded from the definition of legal entity customer and thus are subject to the CCD Rule's beneficial ownership information requirements.
- Foreign Financial Institution Customers: Foreign financial institutions are excluded from the definition of "legal entity customer" *provided that* the foreign regulator for that financial institution collects and maintains information on the beneficial owner(s) of that regulated institution. Accordingly, covered financial institutions should contact the relevant foreign regulator or use other reliable means to ascertain whether the foreign regulator maintains beneficial ownership information for the financial institutions that it regulates or supervises. Covered financial institutions are not required to research the specific transparency requirements imposed on a foreign financial institution by its regulator and compare them with those imposed on US financial institutions by US federal functional regulators.
- Exemption for Private Label Retail Credit Accounts at the Point of Sale: Retail credit accounts opened at the point of sale are generally exempt from the beneficial ownership information requirements of the CDD Rule. This exemption applies to covered financial institutions that open an account for a legal entity customer that is "at the point-of-sale to provide credit products, including commercial private label credit cards, solely for the purchase of retail goods and/or services at these retailers, up to a limit of \$50,000."
- Exemption for Equipment Finance and Leasing: Subject to certain limitations, equipment and finance lease accounts are exempted from the CDD Rule requiring the identification and verification of beneficial owners. The exemption applies to such accounts where "(1) the account's purpose is to finance the purchase or leasing of equipment, (2) payments are remitted directly by the financial institution to the vendor or lessor, and (3) there is no possibility of a cash refund on the account activity." The exemption is intended to cover business equipment such as farm equipment, construction machinery, aircraft, computers, printers, photocopiers and automobiles that a business purchases or leases.

Understanding the Nature and Purpose of Customer Relationships to Develop a Customer Risk Profile

- FinCEN's new FAQs highlight the obligation to understand the nature and purpose of a customer relationship as this forms the basis for the development of a customer risk profile. The information gathered about a customer at account opening and updated and supplemented over time, including beneficial ownership information, is essential to understanding the relationship and developing the profile.
- FinCEN notes that customer information obtained during account opening should be used to serve as a “baseline” against which customer activity—such as the customer’s expected use of wires or typical number of deposits in a month—can be assessed for possible suspicious activity reporting.
- A customer risk profile may, but need not, include a system of risk ratings or categories of customers. Accordingly, the documentation that is required to demonstrate an understanding of the nature and purpose of a customer relationship will vary with the type of customer, account, service or product. It is not a “one size fits all” exercise.
- An understanding based on category of customer means that for certain lower-risk customers, a financial institution’s understanding of the nature and purpose of a customer relationship can be developed by inherent or self-evident information, such as the type of customer or type of account, service, or product or other basic information about the customer including information obtained at account opening.

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