



## Financial Crimes Enforcement Network Releases FAQs on Diligence Procedures for Beneficial Owners of Accounts

On July 19, 2016, the U.S. Treasury's Financial Crimes Enforcement Network ("FinCEN"), issued its Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions ("FAQs").<sup>1</sup> The FAQs provide useful guidance for financial institutions' anti-money laundering and Bank Secrecy Act compliance programs and compliance with FinCEN's customer due diligence requirements ("CDD Rules")<sup>2</sup> published May 11, 2016, in the wake of the release of the "Panama Papers." Although financial institutions do not have to comply with the CDD Rules until May 11, 2018, customer identification programs ("CIP") and money laundering screens should be reviewed and adjusted, if necessary, to meet the CDD Rules prior to the effective date.

FinCEN exercises regulatory functions primarily under the Currency and Foreign Transactions Reporting Act of 1970, as amended by the USA PATRIOT Act of 2001 and other legislation and regulations collectively referred to as anti-money laundering/Bank Secrecy Act ("AML/BSA").<sup>3</sup> Accordingly, FinCEN is authorized to impose AML/BSA requirements on financial institutions, such as requiring financial institutions to maintain AML/BSA compliance procedures to prevent money laundering.<sup>4</sup>

AML/BSA compliance is a high priority for financial institution regulators, and inadequate AML/BSA policies and procedures are likely to result in examination criticism, matters requiring attention ("MRAs"), enforcement actions, possible civil money penalties, and regulatory demands for additional, more effective AML/BSA compliance personnel, systems, and internal controls. Additionally, regulatory ratings may be adversely affected, including the institution's management rating. Both the Bank Holding Company Act of 1956 and the Bank Merger Act specifically require regulators to consider the effectiveness of each party in combating money laundering, including in their overseas branches, when evaluating bank acquisition proposals. Nonbanking activities and acquisitions by bank holding companies also will be adversely affected by inadequate AML/BSA programs. Targets' AML/BSA deficiencies will slow any acquisition, even where the buyer has a strong AML/BSA compliance record.

### Definitions

In addition to the customer information required to be collected under the current CIP requirements,<sup>5</sup> the CDD Rules and the FAQs contain explicit customer due diligence ("CDD") requirements for "covered

financial institutions” to identify and verify the identity of “beneficial owners” of the “accounts” of “legal entity customers.” “Covered financial institutions” generally are: (i) federally regulated banks; (ii) securities brokers or dealers; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers in commodities.<sup>6</sup> “Beneficial owners” are either of the following:

- Individuals, if any, who, directly or indirectly, owns 25 percent or more of the equity interests of a legal entity customer (the “Ownership Prong”); and
- An individual with significant responsibility to control, manage, or direct a 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 (the “Control Prong”).<sup>7</sup>

The FAQs clarify that a legal entity customer will have between one and five beneficial owners (i.e., one person under the Control Prong and zero to four persons under the Ownership Prong).<sup>8</sup>

“Account” means a “formal banking relationship established to provide or engage in services, dealings, or other financial transactions including a deposit account, a transaction or asset account, a credit account, or other extension of credit. Account also includes a relationship established to provide a safety deposit box or other safekeeping services, or cash management, custodian, and trust services.”<sup>9</sup> Accounts do not include:

- A product or service where a formal banking relationship is not established with a person, such as check cashing, wire transfer, or sale of a check or money order;
- An account that the bank acquires through an acquisition, merger, purchase of assets, or assumption of liabilities; or
- An account opened for the purpose of participating in an employee benefit plan established under the Employee Retirement Income Security Act of 1974.<sup>10</sup>

“Legal entity customers” include corporations, limited liability companies, general partnerships, and any similar entity

formed under the laws of a foreign jurisdiction that opens an account with a covered financial institution.<sup>11</sup> The FAQs specify that the definition also includes limited partnerships and any other entity created by the filing of public documents with a Secretary of State. Personal accounts of natural persons, including accounts for sole proprietorships and unincorporated associations, are excluded. The CDD Rules also specifically exclude many foreign and domestic entities, including financial institutions regulated by U.S. federal regulators; banks regulated by U.S. state regulators; foreign and domestic government departments and agencies; corporations listed on the New York, American, or NASDAQ stock exchanges; registered investment companies and registered investment advisors; companies registered with the Securities and Exchange Commission; and other entities regulated at the state and federal level.<sup>12</sup> Trusts generally are excluded, unless, like Delaware statutory trusts, these are created by a filing with a Secretary of State.<sup>13</sup>

## Procedures

As part of the CDD Rules, covered financial institutions must establish and maintain written procedures designed to identify and verify beneficial owners when an account is opened.<sup>14</sup> These procedures must, at a minimum, provide for the beneficial owners’ names, dates of birth, home or office addresses, and tax identification numbers.<sup>15</sup> To gather such information, covered financial institutions may use the sample Certification Form attached as § 1010.230, Appendix A, or any other means *provided that* they comply with the substantive requirements of the CDD Rules and the individual providing such identifying information certifies, to the best of his or her knowledge, the accuracy of the information.<sup>16</sup> Covered financial institutions may rely on photocopies of identification documents, if necessary, to attain the required information under the CDD Rules.<sup>17</sup> Moreover, they do not need to obtain information directly from the beneficial owners. Rather, covered financial institutions may obtain information about beneficial owners from the individual opening the account on behalf of the legal entity customer.<sup>18</sup>

The CDD Rules also require covered financial institutions to implement and maintain appropriate risk-based procedures for conducting *ongoing* CDD, including:

- A system of internal controls;
- Independent testing;
- Designation of a compliance officer or individual(s) responsible for day-to-day compliance;
- Training for appropriate personnel; and
- Appropriate risk-based procedures for conducting ongoing CDD to understand the nature and purpose of customer relationships and to conduct ongoing monitoring to identify and report suspicious transactions, and, on a risk basis, to maintain and update customer information.<sup>19</sup>

Although the CDD Rules will not apply retroactively to accounts opened before the May 11, 2018,<sup>20</sup> current CDD and CIP screening procedures should be updated whenever possible and should be consistent with the CDD Rules and the financial institution's general updating process. Implementing the steps listed above will take substantial time.

## Exemptions and Limitations on Exemptions

CDD Rules do not apply to accounts established:

- At the point-of-sale to provide credit products, solely for the purchase of retail goods and/or services at these retailers, up to a limit of \$50,000; or
- To finance the purchase of postage, insurance premiums, or the purchase or lease of equipment.<sup>21</sup>

However, the CDD Rules will apply to the accounts listed above, *if*:

- The accounts are transaction accounts through which a legal entity customer can make payments to, or receive payments from, third parties; or
- There is the possibility of a cash refund for accounts opened to finance purchase of postage, insurance premium, or equipment leasing.<sup>22</sup>

## Interaction with Existing Legal and Regulatory Requirements

Covered financial institutions should continue to comply with Office of Foreign Asset Control ("OFAC") regulations with respect to beneficial ownership information, which includes the identification of high-risk customers; risk assessments of

transaction parties, including beneficial owners; and certain record retention requirements relating to beneficial owners.<sup>23</sup> Further, FinCEN does not expect the CDD Rules to add additional requirements under Section 314(a) of the USA PATRIOT Act, which requires financial institutions to provide certain information to state and federal law enforcement agencies investigating terrorist activity or money laundering,<sup>24</sup> because Section 314(a) does not require reporting of beneficial ownership information for an account or transaction matching a name subject to a Section 314(a) request.<sup>25</sup>

## Conclusions

The CDD Rules and the FAQs require careful consideration and updating to existing CIP and other AML/BSA policies, procedures, and internal controls. AML/BSA compliance is a matter of great regulatory concern, which has been heightened following the release of the Panama Papers. Early attention to the CDD Rules and the FAQs is desirable, and it is expected to be a topic for regulatory examination and discussion even before the CDD Rules' effective date. Financial institutions also may want to more carefully reevaluate and screen existing and new customer entities, especially in offshore locations, in light of these new rules.

## Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com/contactus/](http://www.jonesday.com/contactus/).

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## Endnotes

- 1 Financial Crimes Enforcement Network, *Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions*, FIN-2016-G003 (July 19, 2016).
- 2 81 Fed. Reg. 29,398 (May 11, 2016).
- 3 See 12 U.S.C. §§ 1829b, 1951–1959, 18 U.S.C. §§ 1956, 1957, and 1960, and 31 U.S.C. §§ 5311–5314 and 5316–5332 and their implementing regulations at 31 C.F.R. Chapter X.
- 4 31 U.S.C. §§ 5318(h)(2) and 5318(a)(2).
- 5 See FAQs, Question 8; 31 C.F.R. § 1023.220.
- 6 31 C.F.R. § 1010.605(e)(1).
- 7 See FAQs, Question 9; 31 C.F.R. § 1010.230, Appendix A; 31 C.F.R. § 1010.230(d). FinCEN expects the control person to be a “high-level official in the legal entity, who is responsible for how the organization is run, and who will have access to a range of information concerning the day-to-day operations of the company.” FAQs, Question 13.
- 8 FAQs, Question 9.
- 9 31 C.F.R. § 1020.100(a)(1); see also, 31 C.F.R. §§ 1023.100(a), 1024.100(a) and 1026.100(a). The CDD Rules adopted the same definition of “account” provided in the CIP rules. FAQs, Question 14.
- 10 31 C.F.R. § 1020.100(a)(2).
- 11 FAQs, Question 20; 31 C.F.R. § 1010.230(e)(1).
- 12 FAQs, Question 21; 31 C.F.R. § 1010.230(e)(2).
- 13 See FAQs, Question 22; 31 C.F.R. § 1010.230(e)(2). The CDD Rules do not supersede existing obligations and practices regarding trusts generally. For instance, the CIP rules note that covered financial institutions “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.” 68 Fed. Reg. 25,113, 25,116 n. 32. (May 9, 2003). 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.” FFIEC, *Bank Secrecy Act/Anti-Money Laundering Examination Manual*, 281 (2014).
- 14 FAQs, Question 4; 31 C.F.R. § 1010.230(a).
- 15 See FAQs, Question 11; See also 31 C.F.R. § 1023.220(a)(2)(i). Non-U.S. persons must provide one or more of the following: taxpayer identification number, passport number and country of issuance, alien identification card number, or the number and country of issuance of any other government-issued document evidencing nationalities or residences and bearing a photograph or similar safeguards. *Id.*
- 16 FAQs, Question 19; 31 C.F.R. § 1010.230, Appendix A.
- 17 FAQs, Question 6.
- 18 FAQs, Question 10.
- 19 31 C.F.R. § 1020.210(b)(emphasis added).
- 20 FAQs, Questions 15 and 16.
- 21 FAQs, Question 17; 31 C.F.R. § 1010.230(h)(1).
- 22 31 C.F.R. § 1010.230(h)(2). If there is the possibility of a cash refund, the financial institution must identify and verify the identity of the beneficial owner(s) either at the initial remittance, or at the time such refund occurs. FAQs, Question 17.
- 23 FAQs, Question 23; OFAC, *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (2014); see also FinCEN, *Guidance on Obtaining and Retaining beneficial ownership Information* (2010).
- 24 31 C.F.R. § 1010.520.
- 25 FAQs, Question 24.