FinCEN’s CDD Rules & BSA Compliance: Why Preparing Now for the Fifth Pillar is Critical

Handout

February 2017

Presented by:
Susan Costonis, C.R.C.M.
Training & Consulting for Financial Institutions
susancostonis@msn.com
Sponsors

Carolinas Credit Union League
Cornerstone Credit Union League
Credit Union Association of the Dakotas
Georgia Credit Union Affiliates
Hawaii Credit Union League
Heartland Credit Union Association
Illinois Credit Union League
Kentucky Credit Union League
League of Southeastern Credit Unions
Louisiana Credit Union League
Maine Credit Union League
Maryland & DC Credit Union Association
Minnesota Credit Union Network
Mississippi Credit Union Association
Montana Credit Union Network
Mountain West Credit Union Association
Nebraska Credit Union League
New Jersey Credit Union League
Credit Union Association of New Mexico
New York Credit Union Association
Northwest Credit Union Association
Pennsylvania Credit Union Association
Tennessee Credit Union League
Association of Vermont Credit Unions
Virginia Credit Union League
West Virginia Credit Union League
Wisconsin Credit Union League

Directed by
The Credit Union Webinar Network

CREDIT UNION WEBINAR NETWORK
Susan Costonis is a compliance consultant and trainer. She specializes in compliance management along with deposit and lending regulatory training and began her career in 1978. Susan has successfully managed compliance programs and exams for institutions that ranged from a community financial institution to large multi-state bank holding companies. She has been a compliance officer for institutions supervised by the OCC, FDIC, and Federal Reserve. Susan has been a Certified Regulatory Compliance Manager since 1998, completed the ABA Graduate Compliance School, and graduated from the University of Akron and the Graduate Banking School of the University of Colorado. She regularly presents to financial institution audiences in several states and “translates” complex regulations into simple concepts by using humor and real life examples.

susancostonis@msn.com (e-mail)

Published by:
Susan Costonis, C.R.C.M
Compliance Training and Consulting for Financial Institutions

All rights reserved. This material may not be reproduced in whole or in part in any form or by any means without written permission from the publisher.

Disclaimer
This presentation is designed to provide accurate and authoritative information in regard to the subject matter covered. The handouts, visuals, and verbal information provided are current as of the webinar date. However, due to an evolving regulatory environment, Financial Education & Development, Inc. does not guarantee that this is the most-current information on this subject after that time.

Webinar content is provided with the understanding that the publisher is not rendering legal, accounting, or other professional services. Before relying on the material in any important matter, users should carefully evaluate its accuracy, currency, completeness, and relevance for their purposes, and should obtain any appropriate professional advice. The content does not necessarily reflect the views of the publisher or indicate a commitment to a particular course of action. Links to other websites are inserted for convenience and do not constitute endorsement of material at those sites, or any associated organization, product, or service.
TABLE OF CONTENTS

OVERVIEW OF THE CDD AND BENEFICIAL OWNERSHIP RULES .......... 5
FINCEN’S CDD RULES – PREPARING FOR THE FIFTH PILLAR .................................................. 6
FOUR KEY ELEMENTS OF THE NEW CDD BENEFICIAL OWNERSHIP RULE .................................................. 7
BACKGROUND FOR BENEFICIAL OWNERSHIP CHANGES .................................................................. 8
BENEFICIAL OWNERSHIP RULE BASICS .......................................................................................... 10
SUMMARY CIP AND BENEFICIAL OWNERS AND RECORD RETENTION .................................................. 16
APPENDIX A – CERTIFICATION FORM .............................................................................................. 17
TIPS FOR DOCUMENTING THE TWO-PRONG TEST ........................................................................... 21
WHAT DOES THE FRONTLINE NEED TO KNOW? ............................................................................. 26
STEPS TO PREPARE FOR THE CHANGES AND TIMELINES ............................................................... 28
WHY BEGIN PLANNING NOW? ......................................................................................................... 30

THE FIFTH PILLAR AND DUE DILIGENCE ................................................................................. 32
OVERVIEW OF DUE DILIGENCE AND NEW RULES ........................................................................... 33
FIFTH PILLAR CHANGES ARE REQUIRED .......................................................................................... 34
TRIGGERING EVENTS AND UPDATING INFORMATION .................................................................... 36
COMPONENTS OF AN EFFECTIVE CDD PROGRAM ........................................................................... 37
BENCHMARKS FOR HIGH RISK AND APPENDIX K ........................................................................... 42
CIP/CDD MATRIX AND APPROACHES .............................................................................................. 44
DUE DILIGENCE AFTER ACCOUNT OPENING .................................................................................. 45
DECISION POINTS AND TIMELINES ................................................................................................. 46
Overview of the CDD and Beneficial Ownership Rules
FINCEN’S CDD RULES – PREPARING FOR THE FIFTH PILLAR

This webinar will discuss two specific items regarding the “fifth pillar” of the new customer due diligence rules. The first is an overview of changes that will mandate additional procedures to “understand the nature and purpose” of the legal entity relationship in order to develop a “reasonable” risk profile. The second portion of the program will discuss how to conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update accountholder information. FinCEN allowed a lengthy time frame for financial institutions to navigate these substantial changes to policies, procedures, forms, and an effective monitoring process. Regulators will expect financial institutions to have an implementation plan well in advance of the May 11, 2018, effective date to meet these challenges.

NOTE: FinCEN uses the term “customer due diligence”; this term has the same meaning as member due diligence. References to “customer” are the equivalent of “member” throughout the materials. Legal Entity Customer is a specific term in the law and was not changed to Legal Entity Member.

HIGHLIGHTS

- How to comply with the four core elements of the CDD rules
- Customer identification and verification
- Beneficial ownership identification and verification of a “legal entity”
- Understand the nature and purpose of customer relationships to develop a customer risk profile
- Ongoing monitoring for suspicious transactions, and, on a risk basis, maintaining and updating customer information
- Documenting the two-prong test for beneficial ownership and control of a legal entity
- What does the frontline and lending staff need to know?
- How will BSA staff, operations, and the audit function support the new rules?
- What new internal controls will be required?
- Tips to identify suspicious activity, beginning with establishing an activity baseline at account opening
- Four unique sources of risk for legal entity accounts, including terrorist financing, money laundering, business identity theft or fraud, and business account takeover
- Events that may trigger an update to the risk profile for both loan and deposit accounts

TAKE-AWAY TOOLKIT
- CDD checklists under the new rules
- Risk profile template
- Sample CDD policy
- Procedures template for identifying and verifying beneficial owners
FOUR KEY ELEMENTS OF THE NEW CDD BENEFICIAL OWNERSHIP RULE

- **Four Key Elements of the NEW CDD Beneficial Ownership Rule:**
  1. Identify and verify the identity of customers (members) who open covered accounts.
  2. Identify and verify the identity of beneficial owners with 25% or more equity interest of a legal entity customer (member).
  3. Understand the nature and PURPOSE of customer (member) relationships.*
  4. Conduct ongoing monitoring to maintain and update customer (member) information and to identify and REPORT suspicious transactions.*

*Elements 3 and 4 contain language from the FFIEC BSA/AML exam manual and many examiners have been expecting these rules for years. Some institutions have either anticipated the changes, and/or based on risk assessment factors, have already begun collecting these additional elements as part of their monitoring efforts. The downside may have been a negative impact to remain competitive with other financial institutions that have more lenient standards. These new rules will remove the competitive issue as this will become federal requirements and active law enforcement tool.
BACKGROUND FOR BENEFICIAL OWNERSHIP CHANGES

SEE TOOLKIT TO FIND THE NEW RULES

The U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) has finalized its long-awaited beneficial ownership rule, which it proposed in 2014. The regulation does two things. First, it extends Customer Due Diligence (CDD) requirements under Bank Secrecy Act (BSA) rules to the natural persons behind a legal entity. Second, the regulation adds a fifth pillar to the traditional “four pillars” of an effective anti-money laundering (AML) program by requiring covered financial institutions to establish risk-based procedures for conducting ongoing customer due diligence. As of May 11, 2018, entities subject to BSA will be required to identify and verify the identity of beneficial owners of legal entity customers at the time the customer opens a new account (deposit and loan accounts), subject to certain exclusions and exemptions, as well as develop risk profiles and conduct ongoing monitoring of customers.

The 2015 National Money Laundering Risk Assessment estimated that the annual volume of money laundering in the United States from financial crimes was $300 billion and FinCEN applied a “breakeven” analysis to evaluate the cost benefits of the 2014 proposal. (See Toolkit for link and highlights)

The Final Rule completes a multi-year effort by FinCEN to establish beneficial ownership requirements for covered financial institutions. Although the USA PATRIOT Act amendments to the BSA in 2001 always contemplated that beneficial ownership information may be required as part of the Customer Due Diligence (CDD) performed by regulated financial institutions, a variety of issues complicated implementation of a broad beneficial ownership reporting requirement. Over the years, the U.S. has faced mounting pressure from its international peers to bring its AML regulations into compliance with international norms established by the Financial Action Task Force (FATF), of which the U.S. is a member, especially with respect to requiring beneficial ownership information. The U.S. is currently undergoing its fourth “mutual evaluation” by FATF, which increased the urgency for U.S. action at this time. The release of a trove of documents on the use of offshore shell companies known as the Panama Papers has provided further fuel for this effort and provided detailed information about how wealthy individuals around the world, including public officials, hide their money from government regulation and public scrutiny—and possibly commit illegal activities—using shell companies.

Among other things, the requirement to collect beneficial ownership information is intended to allow law enforcement to better track illicit use of financial services, in addition to aiding covered financial institutions in complying with sanctions programs administered by the Office of Foreign Assets Control (OFAC). The Final Rule creates a new section in the BSA regulations at 31 C.F.R. § 1010.230 setting forth the beneficial ownership identification requirements for covered financial institutions, as well as a number of exclusions for specific types of customers (members) and accounts. It also amends the respective AML program requirements for these institutions to formally identify customer due diligence as a fifth essential “pillar” of an AML program.
Current Four Pillars for BSA/AML

1. Internal controls;
2. Independent testing;
3. Designation of an individual responsible for day-to-day compliance;
4. Training

Fifth Pillar Under Beneficial Ownership

1. Internal controls;
2. Independent testing;
3. Designation of an individual responsible for day-to-day compliance;
4. Training
5. Obtain beneficial ownership information and:
   i. understand the nature and purpose of customer relationships for the purpose of developing a customer profile, and
   ii. on-going monitoring to identify and report suspicious transactions and, on a risk basis, to update customer information – including beneficial ownership.

The final rule was issued quietly on May 5, 2016, in an advance version, with the official version published in the Federal Register on May 11, 2016. Although the rule will technically become effective July 11, 2016, compliance will not become mandatory until May 11, 2018.

FinCEN’s stated impetus for this rulemaking was its determination, after consultation with the federal financial regulators and the Department of Justice, that more explicit rules for covered financial institutions with respect to CDD were necessary to enhance financial transparency and safeguard the financial system against illicit use. The BSA authorizes FinCEN to impose AML program requirements on all covered financial institutions and to require such institutions to maintain procedures to ensure compliance with the BSA and its implementing regulations or to guard against money laundering.
BENEFICIAL OWNERSHIP RULE BASICS

Beginning on May 11, 2018, covered financial institutions must do two things for all legal entity customers who open new accounts at the financial institution, unless an exception applies: 1) identify and 2) verify the identity of the beneficial owners of the legal entity.

Who is covered by the new rules?

The final rule applies to “covered financial institutions,” which are those already subject to BSA Customer Identification Program (CIP) requirements. These generally include depository institutions securities broker-dealers, mutual funds, and futures commission merchants and introducing brokers in commodities.

The rule does not exclude smaller institutions. FinCEN recognized the increased burden on smaller institutions, but noted that “even though some smaller institutions might be lower risk, size alone should not be a determinative factor for a risk assessment, making it an inappropriate basis for a categorical exclusion.” FinCEN also reiterated that it expects financial institutions to implement procedures for collecting beneficial ownership information that are appropriate for the institution’s size and type of business.

What is an “account?”

Consistent with the proposed rule, the final rule does not apply retroactively; it applies only to legal entity customers who open new accounts on or after the May 11, 2018, compliance date. The term “new account” is defined to include each account opened at a covered financial institution by that customer. In other words, a covered financial institution will be required to identify and verify a legal entity customer’s beneficial owners each time the customer opens a new account at the institution after the compliance date, even if the institution has already identified and verified the customer’s beneficial owners at the time the customer opened a previous account.

What is a “legal entity customer”?

The proposed rule applies to “legal entity customers,” which are generally defined as:

- A corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office,
- A general partnership, and any similar entity formed under the laws of a foreign jurisdiction that opens an account.
What (who) is **exempted** from the definition of a “legal entity customer”? 

A long list of entities are excluded from the definition of “legal entity customer,” including but not limited to:

- Regulated financial institutions;
- Certain governmental agencies;
- Entities whose common stock or equity interest are listed on the New York Stock Exchange or the American Stock Exchange or have been designated as a NASDAQ National Market Security listed on the NASDAQ Stock Market;
- Issuers of classes of securities registered under Section 12 of the Securities Exchange Act;
- Registered investment companies and investment advisers;
- Exchange or clearing agencies;
- Other entities registered with the Securities and Exchange Commission;
- Public accounting firms registered under Sarbanes-Oxley Act;
- Financial institution holding companies;
- Savings and loan hold companies; and
- State-regulated insurance companies.

Certain exemptions to the requirements to identify and verify the identity of each beneficial owner also apply to certain activities. For instance, private label credit card accounts established at the point-of-sale solely for the purchase of retail goods or services at the issuing retailer are not subject to the beneficial owner identification and verification requirements if those accounts have a credit limit of no more than $50,000. Credit cards accepted at any outlet or at an ATM, however, are not exempt. Pooled investment vehicles operated by an excluded entity and certain nonprofit entities are partially exempt in that they are generally subject only to the control prong of the beneficial ownership definition.

**Where do trusts fit in?**

An important point to note is that the “legal entity customer” definition does not apply to most trusts since most trust do not need to file public documents to be created. FinCEN has noted that “identifying a ‘beneficial owner’ from among” trust grantors, trustees, and beneficiaries “would not be possible.”

However, possible or not, FinCEN still believes that some information beneficial ownership information about trust accounts should be obtained in some instances:

Many financial institutions are already taking a risk-based approach to collecting information with respect to various persons associated with trusts in order to know their customer, and industry observers expect financial institutions to continue these practices as part of their overall efforts to safeguard against money laundering and terrorist financing.

**When a trust is a beneficial owner of a legal entity customer, the beneficial owner is to be considered the trustee of the trust.**
**What is the two-prong approach to beneficial ownership?**
The new rule takes a “two-prong approach for the identification of beneficial owners. BOTH must be considered.

1. Ownership
2. Control

✓ **Ownership Prong** – For the ownership prong, identify any natural persons with a 25% or more ownership of the legal entity. *Financial institutions are not required to calculate or determine this and may rely on the certification provided by the customer* (member). *NOTE: If something alerts a financial institution that the information is fraudulent or untrue this should be reported to the BSA Officer and may require that a SAR be filed.*

✓ There is no requirement for the financial institution to determine beneficial ownership or analyze calculations – they may rely on the information that the customer (member) attests is correct on the certification form.

✓ There may be NO beneficial owner with 25% or more. If that’s the case, there are no beneficial owners listed in the ownership prong.

✓ There is no requirement to determine if the entity is structured to avoid the 25% threshold.

✓ If an entity is an owner the financial institution is not required to identify/verify natural persons behind the entity.

✓ A trustee will be classified as the beneficial owner if a trust owns 25% or more of a legal entity.

✓ **Control Prong** – Financial institutions must collect at least one individual on the control prong. This should be the natural person in the management structure who has “significant responsibility to control, manage or direct” the legal entity.

**Who is a “beneficial owner”?**

Under the new rule, a “**beneficial owner**” includes **two types of individuals**: 

1. Any individual who, directly or indirectly, owns 25 percent or more of equity interest in the legal entity customer; and

2. A single individual who has “significant responsibility to control, manage, or direct a legal entity.”

It is not entirely clear what would constitute “significant responsibility” under the second prong, but the rule indicates that such individuals could be an executive officer, senior manager, or any other person who “regularly performs similar functions.”

Under the ownership prong, a legal entity customer could have between zero and four beneficial owners—zero if no individual owns 25 percent or more of an entity or four if each individual owns exactly 25 percent of the entity. For the second, control prong, all legal entities will be required to name at least one individual. Accordingly, each legal entity customer will have between one and five beneficial owners.
Some industry observers have commented that this definition could allow real owners to hide behind an executive serving as a figurehead. Or, there may be multiple people controlling a legal entity and the rule does not take into account the fact that a controlling person may be following instructions provided by someone above if though that person actually has no real ownership of the company.

**What is Required?**

**Certification Issues** - The financial institution may comply either by **obtaining the required information on a standard Certification Form** (see sample APPENDIX A form) provided by the rule or by any other means that comply with the substantive requirements of the provision. The rule does not list specific individuals who would be appropriate to certify an entity’s beneficial owners, but FinCEN does state that the form does not need to be notarized or approved by the financial institution’s board of directors or any other governing body.

FinCEN makes some important clarifications and amendments regarding the use of standard certification forms issued by FinCEN. Unlike in the proposal, covered financial institutions are permitted but not required to use the standard certification form to collect information regarding the identity of beneficial owners of legal entity customers. Instead, covered financial institutions may “obtain the information through their standard account opening process without utilizing the Certification Form…” provided that the institution collects the information required to be included on the form and the individual completing the form on behalf of the legal entity customer certifies to the best of his or her knowledge that the information in the form is true and correct. See, FinCEN Preamble, p. 29-31.

While FinCEN declines to impose specific account-opening procedures in the final beneficial ownership rule, it does offer some commentary in the preamble regarding the individuals that should be completing the certification form:

FinCEN understands that financial institutions generally have long-standing policies and procedures, based on sound business practices and prudential considerations, governing the documentation required to open an account for a legal entity; these typically include resolutions authorizing the entity to open an account at the institution and identifying the authorized signatories. Such resolutions are typically certified by an appropriate individual, e.g., the secretary or other officer of a corporation, a member or manager of an LLC, or partner of a partnership. It would be appropriate for the same individual to certify the identity of the beneficial owners. Such an individual would typically have at least some familiarity with the entity’s owners and with individuals with responsibility to control or manage the entity, but may not have personal knowledge of individuals having an indirect ownership interest through, for example, intermediate legal entities or contractual arrangements with nominal owners, and would have to rely on others for any such information.
See, FinCEN Preamble, p. 32. Therefore, it appears that FinCEN expects the individual completing the certification form detailing the beneficial ownership of a legal entity customer will be someone with some familiarity with the customer’s corporate structure such as a senior management official or the secretary of the board.

Furthermore, when verifying the identity of an individual identified as a beneficial owner, the final beneficial ownership rule will require covered financial institutions to perform verification procedures containing the “elements required for verifying the identity of customers that are individuals under paragraph (a)(2) of the applicable [customer identification program] rule.” See, FinCEN Preamble, p. 40. These procedures, however, are not required to be identical. This is a departure from the proposed rule which would have required covered financial institutions to perform verification procedures identical to the institution’s existing CIP procedures.

While use of the standard Certification form would provide institutions certain protections, FinCEN has stopped short of providing a blanket safe harbor by use of the Certification Form. Instead, the final rule allows covered financial institution to rely on information that the legal entity customer supplies about the identity of its beneficial owners, so long as the institution does not have “knowledge of any facts that would reasonably call into question the reliability of such information.”

✓ TO DO:

Read the initial FAQs from FinCEN that were published July 2016 and are found in the SUPPLEMENT. Expect ADDITIONAL clarification and NEW exam procedures and regulatory guidance to be issued in 2017!

✓ TO DO:

Credit unions have been required to resolve CIP discrepancy issues since October 10, 2003. Lenders are required to resolve address discrepancy issues under the FCRA when pulling credit reports and check for identity theft alerts.

ADD A PROCEDURE AND MONITORING PROCESS FOR THIS NEW “KNOWLEDGE OF ANY FACTS THAT WOULD REASONABLY CALL INTO QUESTION RELIABILITY OF SUCH INFORMATION” REQUIREMENT THAT BECOMES EFFECTIVE MAY 11, 2018.

TRAIN STAFF, AND TRAIN AGAIN AND AGAIN.

The financial institution may rely on the beneficial ownership information supplied by the customer, provided that it has no knowledge of facts that would reasonably call into question the reliability of the information. The identification and verification procedures for beneficial owners are very similar to those for individual customers under a financial institution’s customer identification program (CIP), except that for beneficial owners, the
institution may rely on copies of identity documents. Financial institutions are required to maintain records of the beneficial ownership information they obtain, and may rely on another financial institution for the performance of these requirements, in each case to the same extent as under their CIP rule.

In one of the most significant departures from the ANPRM, FinCEN’s latest proposal would no longer require financial institutions to verify that the individuals listed as beneficial owners on the self-certification were actually the owners of the legal entity. This is referred to as verifying “status” of beneficial owners in the proposed rules. Instead, institutions will be allowed to simply verify that the persons listed as the beneficial owners exist, using procedures already in place from their customer identification program to confirm their identity. In many cases, institutions will be able to satisfy this requirement by collecting a driver’s license, passport, or similar government-issued documentation for the individuals listed as beneficial owners.

Collection of beneficial owners’ sensitive personal information (e.g., name, date of birth, Social Security number, and passport number, if the beneficial owner is not a U.S. person) may raise privacy concerns and increase fears of identity theft. Nevertheless, FinCEN has said these concerns are insufficient to justify limiting the collection of this information and pointed out that financial institutions are required to protect this information under the Gramm-Leach-Bliley Act and Right to Financial Privacy Act.

FinCEN states that financial institutions should use beneficial ownership information as they use other information they gather regarding customers (e.g., through compliance with CIP requirements), including for compliance with the Office of Foreign Assets Control (OFAC) regulations, and the currency transaction reporting (CTR) aggregation requirements under the BSA.

**What records are required? What is the retention period?**

Consistent with CIP rules, records of information collected in connection with identifying and verifying beneficial owners must be retained for five years after the account is closed, for identification records, and five years after the record is made, for verification records. For identification, the records must include, at a minimum, any identifying information the institution obtained, including the Certification Form, if it was obtained. For verification, a covered institution must maintain a description of any document the institution reviewed to verify the beneficial owner’s identity, noting the type, any identification number, any place of issuance, any date issuance, and any expiration date.
SUMMARY CIP AND BENEFICIAL OWNERS AND RECORD RETENTION

A covered financial institution (FI) must verify the identity of each party listed as a beneficial owner using documentary or non-documentary means or a combination of the two. The FI may require the person opening the account to provide a photocopy of each beneficial owner’s identification.

Note: The FI may use the CIP it uses for its customers or a modified version with somewhat different characteristics; e.g., it may need to revise its CIP in order to allow the use of a

- Photocopy of identification.
- A documentary rather than a non-documentary method for verifying the beneficial owner’s name/TIN combination.

Note: The FI is only required to verify the beneficial owners’ existence, not their status as owners. There are no states that require all legal entities to disclose ownership information at the time of formation or in their subsequent reports. *Verification is not feasible until there is uniformity to require this information in all states.*

<table>
<thead>
<tr>
<th>Financial institutions must retain...</th>
<th>For a FIVE-year period after</th>
</tr>
</thead>
<tbody>
<tr>
<td>The <strong>identifying information</strong> obtained and the <strong>certification</strong></td>
<td>The account is closed.</td>
</tr>
<tr>
<td><strong>A description</strong> of the:</td>
<td>The information is obtained.</td>
</tr>
<tr>
<td>• Documents it used to verify identity (noting the type, any identification number, place of issuance, date of issuance, and expiration),</td>
<td></td>
</tr>
<tr>
<td>• The methods and results of any measures undertaken to verify identity, and</td>
<td></td>
</tr>
<tr>
<td>• The resolution of any substantive discrepancy discovered when verifying the information it received.</td>
<td></td>
</tr>
</tbody>
</table>
I. GENERAL INSTRUCTIONS

What is this form?
To help the government fight financial crime, Federal regulation requires certain financial institutions to obtain, verify, and record information about the beneficial owners of legal entity customers. Legal entities can be abused to disguise involvement in terrorist financing, money laundering, tax evasion, corruption, fraud, and other financial crimes. Requiring the disclosure of key individuals who own or control a legal entity (i.e., the beneficial owners) helps law enforcement investigate and prosecute these crimes.

Who has to complete this form?
This form must be completed by the person opening a new account on behalf of a legal entity with any of the following U.S. financial institutions: (i) a bank or credit union; (ii) a broker or dealer in securities; (iii) a mutual fund; (iv) a futures commission merchant; or (v) an introducing broker in commodities.

For the purposes of this form, a legal entity includes a corporation, limited liability company, or other entity that is created by filing of a public document with a Secretary of State or similar office, a general partnership, and any similar business entity formed in the United States or a foreign country. Legal entity does not include sole proprietorships, unincorporated associations, or natural persons opening accounts on their own behalf.

What information do I have to provide?
This form requires you to provide the name, address, date of birth and Social Security number (or passport number or other similar information, in the case of foreign persons) for the following individuals (i.e., the beneficial owners):

i. Each individual, if any, who owns, directly or indirectly, 25 percent or more of the equity interests of the legal entity customer (e.g., each natural person that owns 25 percent or more of the shares of a corporation); and

ii. An individual with significant responsibility for managing the legal entity customer (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, or Treasurer).

The number of individuals that satisfy this definition of “beneficial owner” may vary. Under section (i), depending on the factual circumstances, up to four individuals (but as few as zero) may need to be identified. Regardless of the number of individuals identified under section (i), you must provide the identifying information of one individual under section (ii).
NOTE: It is possible that in some circumstances the same individual might be identified under both sections (e.g., the President of Acme, Inc. who also holds a 30% equity interest). A completed form will contain the identifying information of at least one individual (under section (ii)), and up to five individuals (i.e., one individual under section (ii) and four 25 percent equity holders under section (i)). The financial institution may also ask to see a copy of a driver’s license or other identifying document for each beneficial owner listed on this form.

CERTIFICATION OF BENEFICIAL OWNER(S)
Persons opening an account on behalf of a legal entity must provide the following information:

Name and Title of Natural Person Opening Account:

Name and Address of Legal Entity for Which the Account is Being Opened:

The following information for each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of the legal entity listed above:

<table>
<thead>
<tr>
<th>Name/Title</th>
<th>Date of Birth</th>
<th>Address (Residential or Business Street Address)</th>
<th>For U.S. Persons Social Security Number</th>
<th>For Foreign Persons Passport Number and Country of Issuance, or other similar identification number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(If no individual meets this definition, please write “Not Applicable.”)
The following information for one individual with significant responsibility for managing the legal entity listed above, such as:

- An executive officer or senior manager (e.g., Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, Treasurer); or
- Any other individual who regularly performs similar functions.

(If appropriate, an individual listed under section (c) above may also be listed in this section (d)).

<table>
<thead>
<tr>
<th>Name/Title</th>
<th>Date of Birth</th>
<th>Address (Residential or Business Street Address)</th>
<th>For U.S. Persons Social Security Number</th>
<th>For Foreign Persons Passport Number and Country of Issuance, or other similar identification number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

I --------------------------------- (name of natural person opening account), hereby certify, to the best of my knowledge, that the information provided above is complete and correct.

Signature:    Date:

1 In lieu of a passport number, foreign persons may also provide an alien identification card number, or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

Legal Entity Identifier(Optional)
Suggestion: The use of this form does not offer a safe harbor as provided in other compliance regulations. However, it is a specific form provided in the new rules. One simple method to complete customer due diligence for the new rules might be to ADD a column to the form after the “foreign persons” column that indicates the specific ID that was relied on to establish the identity of individuals listed on the form. Was it a copy of the driver’s license? What was the issue date? What was the expiration date? What state or country issued the document? How did you verify the social security number for U.S. persons? What address was used? Why

OPTION 1 – Use Appendix A (or a modified version) as a paper form to gather the required information with the person opening the account certifying that, to the best of his or her knowledge, the information is accurate.

OPTION 2 – Do not use Appendix A in paper form; obtain the information from the individual opening the account by any other means. However, the person opening the account must certify that, to the best of his or her knowledge, the information is accurate. Financial institutions can modify Appendix A, but must retain the certification portion. Any modification of what amounts to a “model form” must be done cautiously. For example, the modification absolutely cannot reduce the amount of information required. Increasing it should not be a problem.

Some potential revisions could be:
- ✓ Document the type of entity
- ✓ Entity’s taxpayer identification number
- ✓ Entity’s physical address (note that Appendix A does not specify what address is required)
- ✓ Document whether each individual listed is an existing customer (member) previously subjected to CIP; i.e., “Yes” or “No”
- ✓ Describe how individual’s identity was verified, describing both documents and non-documentary methods used
- ✓ Require the phone number of each individual listed
- ✓ Require the beneficial owners’ individual percentage of ownership
- ✓ Require the individual opening the account to be an officer, member, or partner of the legal entity
- ✓ If the customer (member)is excluded from the definition of legal entity indicate why and document as required by policy. EXAMPLE – if the customer (member) is a nonprofit the beneficial ownership is not required, but questions must be asked about control of the nonprofit. (See page 29416 of Federal Register)
- ✓ Require the person opening the account to either:
  - Be an existing customer (member) on whom CIP has been performed or
  - Agree (in writing) that the financial institution can perform CIP on him or her

✓ TO DO:
CHECK WITH YOUR REGULATOR
ABOUT COMPLIANCE EXPECTATIONS!
REMEMBER THAT BSA COMPLIANCE IS BASED ON RISK!
TIPS FOR DOCUMENTING THE TWO-PRONG TEST

These tips are based on selected FinCEN’s comments.

- **TIP – KNOW WHICH LEGAL ENTITY CUSTOMERS ARE COVERED. GO TO THE APPROPRIATE OFFICE FOR YOUR STATE AND BEGIN TO DEVELOP A LIST OF POTENTIAL LEGAL ENTITY CUSTOMERS.**

**Legal entity customer:** The Final Rule only applies in relation to beneficial ownership information for “legal entity customers,” which are defined to include any corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entity formed under the laws of a foreign jurisdiction that opens an account.

FinCEN clarified that this definition does not include sole proprietorships or unincorporated associations because neither is an entity with legal existence separate from the associated individual or individuals. The definition also does not include natural persons opening an account on their own behalf. Nor does it include trusts (other than statutory trusts created by a filing with a Secretary of State or similar office). With regard to so-called “intermediated account relationships,” (such as, for example, when a broker-dealer opens an account with a mutual fund to engage in transactions on behalf of its customers) FinCEN explained that in cases where existing guidance provides that a bank or credit union shall treat an intermediary (and not the intermediary’s customers) as its customer for purposes of the Customer Identification Program (CIP) rules, the credit union should likewise treat only the intermediary as its customer for purposes of the new beneficial ownership requirement.

- **TIP – ESTABLISH RISK-BASED PROCEDURES TO IDENTIFY BENEFICIAL OWNERS AND HOW TO DOCUMENT CONTROL**

**Definition of “beneficial owner”**: The Final Rule defines beneficial owners as those individuals meeting either of two prongs:

**Ownership prong:** Beneficial owners identified under this prong are defined as “[e]ach individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of a legal entity customer.” FinCEN stated that it intended the term “equity interest” to be “broadly applicable” and declined to further clarify the definition beyond describing it as “an ownership interest in a business entity” and referring to examples provided in its earlier notice of proposed rulemaking (NPRM). FinCEN confirmed that the phrase “directly or indirectly” meant that the covered financial institution’s customer must identify its ultimate beneficial owner[s] and not their nominees or “straw men.”

- No expectation to “affirmatively investigate” equity holding structures, but some circumstances may require filing a Suspicious Activity Report (SAR). FinCEN
reiterated that it does not expect covered financial institutions or customers to undertake analyses to determine whether an individual is a beneficial owner under the definition, and “emphasize[d] that FinCEN expects that covered financial institutions will generally be able to rely on the representations of the customer when it identifies its beneficial owners.” Along the same lines, FinCEN does not expect covered financial institutions to “affirmatively investigate” whether equity holders are attempting to structure their holdings to evade the 25 percent threshold for reporting. However, FinCEN expects that if a covered financial institution knows, suspects, or has reason to suspect that such behavior is occurring, it may, depending on the circumstances, be required to file a SAR.

 Covered financial institutions may establish a threshold below 25 percent based on their own assessment of risk. Although FinCEN recognizes that some covered financial institutions already collect beneficial ownership information at a threshold lower than 25 percent in some cases, it declined to impose a lower ownership threshold. However, FinCEN noted that covered financial institutions may establish a lower percentage threshold for beneficial ownership (i.e., one that regards owners of less than 25 percent equity interests as beneficial owners) based on their own assessment of risk in appropriate circumstances.

 Special circumstances involving trusts and entities excluded from the definition of “legal entity customer.” The Final Rule specifies that 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 prong shall mean the trustee. The Final Rule also specifies that where one of the entities holding 25 percent or more of the equity interests of a legal entity customer is itself excluded from the definition of a “legal entity customer,” no individual need be identified under the control prong.

Control Prong: Beneficial owners identified under this prong are defined as “[a] single 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.
- FinCEN declined to provide additional information about the types of persons who would satisfy the control prong and stated that “the control prong provides for a straightforward test: the legal entity customer must provide identifying information for one person with significant managerial control[,]” and that the Final Rule provides common examples to illustrate.

There are variations on the number of beneficial owners identified under the ownership and control prongs.

FinCEN recognized that, under the ownership prong, depending on the factual circumstances, as few as zero and as many as four individuals may need to be identified. All entities, however, would be required to identify one beneficial owner under the control prong. It is
possible that in some circumstances the same person or persons might be identified under both the ownership and the control prongs. FinCEN further noted that covered financial institutions had the discretion to identify additional beneficial owners as appropriate based on risk.

✓ TIP – IDENTIFY WHEN UPDATED BENEFICIAL OWNER INFORMATION MAY BE TRIGGERED FOR EXISTING CUSTOMERS (MEMBERS)

Monitoring of beneficial ownership under the ownership and control prongs.
FinCEN noted that it would be impracticable for covered financial institutions to monitor the equity interests and management team of legal entity customers on an ongoing basis and continually update this information. It “emphasiz[ed] that the obligation for identification and verification should be considered a snapshot at the time that a new account is opened, not a continuous obligation.” However, FinCEN does expect covered financial institutions to update this information episodically based on risk, generally triggered by a financial institution learning through its normal monitoring of facts indicative of a change in beneficial ownership relevant to assessing the risk posed by the customer. This presents a second way that a pre-existing customer of a covered financial institution might have to provide beneficial ownership information, in this case even if no new account has been opened. This obligation to update arises from the general CDD obligation FinCEN codifies in the new rule that covered financial institutions must update all customer information on a risk basis, i.e., when customer information changes in a way that may affect its risk profile.

✓ TIP – DEVELOP PROCEDURES FOR USING THE STANDARD CERTIFICATION FORM OR AN EQUIVALENT PROCESS.

Identification and Verification of Beneficial Ownership Information:
Methods of obtaining information: Under the Final Rule, covered financial institutions have the option of (1) using a standard certification form or (2) obtaining the information required by the form by another means (such as the covered financial institutions’ own form). However, identification procedures used by covered financial institutions must, like the certification, contain the same elements of the applicable CIP rule, including names, addresses, dates of birth and relevant Taxpayer Identification Numbers. This information will be required whether or not the certification form is used.

Certification by a natural person authorized by the customer to open accounts:
Regardless of whether the standard certification form is used or not, beneficial ownership information must be, at the time of account opening, both (1) current, and (2) certified by a natural person authorized by the customer to open accounts at financial institutions to be accurate “to the best the individual’s knowledge.” FinCEN elaborated on the certification requirement as follows:

The certification of accuracy may be obtained without use of the certification form “in the same way the financial institution obtains other information from its customers in connection with its account opening procedures.”
FinCEN declined to impose specific account opening procedures on covered financial institutions, such as further specifying who an appropriate individual would be to certify the identity of the beneficial owner.

FinCEN declined to require a heightened knowledge threshold, or notarization, or board approval requirement for the certification requirement because the time needed to obtain these would delay account opening without commensurate benefit. Instead, the “best of the individual’s knowledge” standard anticipates that while the individual making the certification appropriately will be an officer with substantial knowledge of the company, such as a corporate secretary, such a person still may not have personal knowledge of individuals having an “indirect ownership interest through, for example, intermediate legal entities or contractual arrangements with nominal owners” that he would need to certify at a higher standard.

**Verification of identity of, not status as, beneficial owner is required:**
FinCEN confirmed its earlier proposal that verification meant that covered financial institutions were required only to verify the identity of the individual identified as a beneficial owner (i.e., to verify the individual’s existence), and not his or her status as a beneficial owner.

- Methods for obtaining verification: The procedures for verifying beneficial owner identity must, at a minimum, contain the same elements required under the institution’s CIPs for verifying the identity of customers who are individuals, though they need not be identical, recognizing that some methods of verification may simply not be practicable for beneficial owners. In particular, in cases where documentary verification is used, covered financial institutions may rely on photocopies of identifying documents rather than originals.

**Financial institution reliance on certification by the legal entity customer:**
FinCEN declined to include in the Final Rule a blanket safe harbor triggered by the use and collection of the standard certification form. Instead, it added language to the Final Rule explaining that financial institutions could rely on the beneficial ownership information given by the person opening the account provided that the financial institution “has no knowledge of facts that would reasonably call into question the reliability of such information.” Although FinCEN made clear that “in the overwhelming majority of cases” reliance on such certifications will be appropriate, FinCEN’s retention of this language instead of a categorical safe harbor serves as a caution against willful blindness in cases where covered financial institutions have facts available to them suggesting that the information may be faulty, and indicates that they might be held liable for relying on false or incorrect certifications in such cases. In keeping with this, FinCEN also noted that beneficial ownership identification procedures, similar to required CIPs, must address situations in which the covered financial institution cannot form a reasonable belief that it knows the true identity of the beneficial owner of a legal entity customer after following the required procedures.

**Reliance on Determinations of Beneficial Ownership by other Covered Financial Institutions:** Similarly to CIPs, covered financial institutions, may rely on the performance by another financial institution (including an affiliate) of the requirements of the beneficial
ownership obligation with respect to any legal entity customer of the financial institutions that
is opening, or has opened, an account or has established a similar business relationship with
the other financial institution to provide or engage in services, dealings, or other financial
transactions, provided that:

✓ Such reliance is reasonable under the circumstances.
✓ The other financial institution is subject to a rule implementing 31 U.S.C. 5318(h) and
  is regulated by a federal functional regulator.
✓ The other financial institution enters into a contract requiring it to certify annually to
  the covered financial institution that it has implemented its anti-money laundering
  program, and that it will perform (or its agent will perform) the specified requirements
  of the covered financial institution’s procedures to comply with the requirements of
  this section.
WHAT DOES THE FRONTLINE NEED TO KNOW?

The frontline (both deposit and lending staff) will need to know HOW TO IDENTIFY THE SPECIFIC TYPES OF LEGAL ENTITIES THAT ARE SUBJECT TO THE NEW RULES ON AND AFTER MAY 11, 2018. CREATE LISTS AND EXAMPLES

Not all legal entities are subject to the rules. Also, FinCEN does not expect financial institutions to conduct any legal analysis to determine whether or not a legal entity can be excluded from the beneficial owner rules. Rather, FinCEN has stated that, absent any knowledge to the contrary, they expect financial institutions to rely upon the representations of these customers.

Charities and Nonprofits – Excluded from the “Beneficial Owner” prong ONLY:
Any legal entity that is established as a nonprofit corporation or similar entity and has filed its organizational documents with the appropriate State authority (i.e., Secretary of State) must comply only with the “control prong” by identifying/verifying the individual with significant managerial control.

Covered legal entities include charitable, non-profit, non-stock, public benefit, or similar corporations. Evidence that an organization qualifies for only the control prong can be obtained via a certified copy of its Certificate of Incorporation or Certificate of Good Standing from the Secretary of State (or appropriate State authority). Most likely this is already required for an entity to open an account under your current CIP procedures.

Unincorporated Associations, Sole Proprietorships, and Trusts are excluded:
Unincorporated associations, such as local community organizations like Scout Troops, youth sports leagues, are not legal entities and a sole proprietorship is an individual, not a legal entity. Therefore, these entities are not included in the definition of a legal entity. Trusts are also not included, unless they are statutory trusts created by a filing with a Secretary of State or similar office.

There are sixteen exemptions from the definition of a legal entity. Frontline staff should NOT be expected to become experts in legal documentation, but internal controls should help remind them of common exemptions for:

- Federal or State Regulated Financial Institutions;
- Bank or Savings & Loan Holding Companies [refer to 1010.230(e)(2)(x)];
- Governmental Departments or Agencies of the United States, of any State, or of any political subdivision of any State;
- Entities established under U.S. or State law; or any political subdivision that exercises governmental authority;
• Publicly Traded Companies listed on a major exchange;
• Subsidiaries of a publicly traded company listed on a major exchange;
• State-regulated insurance companies;
• Investment Companies and Advisors registered with the Securities and Exchange Commission;
• Public Accounting Firms registered under section 102 of the Sarbanes-Oxley Act.

Frontline staff will need to:

(1) Know how to document the type of legal entity that is covered by the rules.
(2) Know how to document WHY the customer (member) was excluded from the legal entity coverage (i.e., if the customer (member) is a publicly traded account how was this verified?).
(3) Know the TYPES of legal entities that are recognized in the STATE where your financial institution is located and HOW to verify the information.
(4) Know what questions must be asked AT account opening to develop a customer profile that is risk-based and follows the revised CDD policy and procedures for the Fifth Pillar requirements. This includes asking about the beneficial owners and at least one person who has control of the legal entity. Are there any circumstances to require more than one individual with control? NOTE: Risk-based procedures could include identification of beneficial owners with LESS than 25% ownership. If a stricter standard is adopted for higher-risk customers, the frontline needs to know how to identify these customers (members).
(5) Know the acceptable forms of identification.
(6) Know that there are NO “grandfathering” provisions and that the verification and certification has to be completed for each covered legal entity account opened on or after May 11, 2018.
(7) Know how to complete the specific form used for the required information. (Model Certification or a revised form or software.)
(8) Know that any changes in beneficial ownership of existing covered legal entities that are found in the normal monitoring process (like a change of signers, change in officers) may require updated information regarding the beneficial owners.
(9) Know what satisfies the “reasonable belief” standard of the legal entity identification and requirements for the revised CDD procedures.
(10) Know the red flags for reporting potential suspicious activity.
STEPs TO PREPARE FOR THE CHANGES AND TIMELINES

In preparation for the mandatory compliance date of May 11, 2018, financial institutions should evaluate their current identification, verification and monitoring processes to determine whether changes may be warranted and what employee training is needed. Covered institutions may also need to amend their BSA programs to include the new fifth pillar if the institution does not already conduct ongoing CDD as contemplated by the rule and document the appropriate procedures.

✓ TO DO:
WATCH FOR UPDATES TO BSA EXAM PROCEDURES! USE THE PROCEDURES AS A TEMPLATE FOR INTERNAL MONITORING AND AUDIT

When it comes to AML/BSA procedures, credit unions should look at updating:

✓ Internal controls;
✓ Independent testing procedures; and
✓ Risk-assessment procedures;

Compliance experts recommend that credit unions also begin to consider how they will:

✓ Ensure their third-party processor is aware of the new information and monitoring requirements and will have the financial institution’s system updated no later than May 11, 2018;
✓ Determine how the credit union will identify the beneficial owners of any legal entity accounts and talk to their processors to see whether the certification form provided in the regulation can be incorporated into an electronic records system;
✓ Update account opening procedures to include the identification of the beneficial owners of business accounts and any other “legal entity” accounts;
✓ Update Customer Identification Program (CIP) procedures to include the methods that will be used to verify beneficial owners of legal entity accounts; and
✓ Ensure that all appropriate personnel are trained on the new policies and procedures developed to meet the compliance requirements of this new rule.

These actions will be critical to complying with the final rule upon its compliance date. It is also important to keep in mind that federal functional regulators may set their own, additional supervisory expectations, as with any other aspect of BSA/AML.

Each financial institution will be held to completing an initial CDD for each legal entity that opens a deposit account or loan and should consider whether the verification procedures authorized by the Final Rules will be adequate in the particular lending circumstances. Even though it appears that a beneficial owner’s ownership status can be confirmed by a
management official of a legal entity, it is possible that prudent underwriting (that is subject to after-the-fact reviews by the prudential regulators of financial institutions and credit unions will require more than the execution of a one-page form document.

**STEP ONE**
- Test the requirements of your CIP as if you were attempting to use it on an individual who is not present and for whom you only have a photocopy of identification.
- **Will your existing CIP actually work on beneficial owners?**
- A photocopy of the driver’s license may verify name, address, and date of birth, but not the NAME/TIN combination.
- **CHALLENGE** – However, verifying a name/TIN combination on a person who is not applying to do business with your institution is difficult. Documentary verification would require a second document
- The preamble to the final CIP rules issued in May 9, 2003 said that a financial institution “need not establish the accuracy of every element of identifying information obtained, but it must do so for enough information to form a reasonable belief that it knows the true identity of the customer.

**STEP TWO**
- Establish a CIP for beneficial owners that is different than your “customer” CIP, a “Beneficial Ownership CIP”
- List acceptable forms of identification
- Establish acceptable criteria for identification; (can it be in a foreign language or must it be in English, is it legible?)
- Indicate whether faxed identification is acceptable
- Require two forms of identification
- Require original identification

**STEP THREE**
- The policy should establish a timeframe related to account opening in which verification must take place
  - Prior to opening the account
  - Within a reasonable timeframe after account opening
- The policy should also outline:
  - What happens when the financial institution is unable to verify the existence of one or more beneficial owners?
  - When are problems with obtaining the certification escalated to SAR consideration; how is this done?
- **TO DO** – See the “Procedures Template – Getting Ready Tasks” in the TOOLKIT
WHY BEGIN PLANNING NOW?

FinCEN received many comment letters that outlined the increased regulatory burden for complying with these changes. One concession to these comments was allowing a TWO YEAR, not the typical 12-month lead time for prepare. Why begin planning now?

Regulators will expect that each financial institution is preparing for these substantial requirements that require these actions:

✓ Review and revise current policies,
✓ Review and revise current procedures, processes, forms,
✓ Review and revise current core software systems, Anti-Money Laundering (AML) software (if applicable),
✓ TRAIN employees and educate the customers (members)!
✓ Two years will go quickly to implement the scope of these sweeping changes!
✓ In addition, there is already an expectation from regulators that financial institutions be fully aware of the final rule’s requirements and have an action plan in place.

CRITICAL TASKS:
(1) Inform MANAGEMENT of the change and document this in the Board minutes.
(2) Identify ALL areas of the financial institution that will be impacted by these changes.
(3) Assign responsibility for each functional area to implement procedures for the rules
(4) Inventory the current data processing options for CIP and CDD. Investigate options for automation
(5) Develop an action plan for implementation.
(6) Test and train
(7) Determine a TARGET date for completion in advance of the mandatory compliance date of May 11, 2018.

MONITOR YOUR PRIMARY REGULATOR’S WEBSITE AND FINCEN FOR UPDATES
SEE THE TOOLKIT FOR THE CHECKLIST FOR IMPLEMENTATION STEPS, TEMPLATES, AND SAMPLE POLICIES.

THESE MUST BE MODIFIED TO FIT YOUR FINANCIAL INSTITUTION’S PRODUCTS, SERVICES, CUSTOMERS, GEOGRAPHIES, AND RISK ASSESSMENT PROFILE!
Suggestion: Use the words and language in the regulation and preamble such as “ongoing, risk profile, risk-based, baseline”, etc.
Education and Training of Legal Entities
Clearly the beneficial ownership obligations will come as a shock to many customers—who traditionally have used legal entities to shield investors from scrutiny and disclosure. In that regard, financial institutions may consider the possibility of educating the borrower community regarding these new disclosure obligations—including the borrower’s legal counsel—who may play an important role when counseling a newly formed legal entity that transparency in ownership should now be expected.

Unanswered Questions and Challenges
The adoption of the Final Rules brings AML, OFAC and similar laws into greater symmetry, which is a declared goal by FinCEN and federal and law enforcement officials. While the new rules are intended to “follow the money” and improve option to detect criminal and terrorist activity through a “new and improved” AML compliance program, the new rules also create many additional ambiguities that will eventually have to be considered financial institutions.

Several issues that have already been identified are as follows:
First, it is very possible that the minimum beneficial ownership standards for CDD contained in the Final Rules will be adjusted to a higher, more robust level by the regulators. Care must be exercised by financial institutions to anticipate any such determination so that the contractual obligations of a legal entity conform to current legal requirements for CDD (as adjusted from time to time). Many financial institutions have experienced negative BSA exam results because they didn’t take issues like MSB registration seriously when the requirements were first introduced.

Second, even though the final rules are applicable to accounts opened on and after May 11, 2018, it is also very possible that the regulators will require that the beneficial ownership CDD be implemented by lending financial institutions earlier than that date. Particularly in light of the detailed changes that must be made to a financial institution underwriting and documentation policies and procedures, prudence may dictate implementing the new CDD requirements sooner rather than later. Industry experts suggest that the setting a TARGET date for policy and procedures for the new rules be in place no later than May of 2017.

Third, in regard to reliance on another financial institution to certify and identify a financial institution legal entity customer, that third-party institution’s attestation is conditioned on the execution of a contract with the third-party institution certifying the effectiveness of its own AML program.
The Fifth Pillar and Due Diligence
Due diligence should be done at account opening and during the LIFE of the account or loan. CIP is a critical step in due diligence.

Customer due diligence (CDD) consists of routine questions which help predict account activity, but specifically identify persons and entities that may warrant enhanced due diligence. NEW RULES for Beneficial Ownership mandatory 5/11/18

Enhanced due diligence (EDD) includes extra questions and verification. If there is a “higher risk” potential for money laundering, then more information is required to predict account activity and increase the financial institution comfort level with the customer. “Higher risk” may be designated because of business activity, ownership structure, the anticipated or actual volume and types of transactions, including those located in high-risk jurisdictions.

Customer identification program (CIP) describes routine requirements for specific information which identifies the person or entity. Verification by documentary or non documentary methods is required by law. NEW BENEFICIAL RULES ARE MANDATORY, NO exceptions.
FIFTH PILLAR CHANGES ARE REQUIRED

The final rule also amends AML program requirements for each type of covered financial institution by adding (at a minimum) the requirement that institutions implement risk-based procedures to conduct ongoing customer due diligence, including understanding the nature and purpose of customer relationships to develop a customer risk profile. According to FinCEN, an institution must develop a using the information the institution gathers about the customer at account opening and use that customer risk profile as a baseline against which the institution will assess future customer activity for potential suspicious activity reporting. For instance, the profile may include the type of customer or type of account, service, or product type.

When a financial institution detects information (including a change in beneficial ownership information) about the customer in the course of its 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. Think of these updates as triggering events, much like a change in the flood zone designation with FEMA remaps an area the financial institution is notified by the life of loan monitoring company.

Such information could include a significant and unexplained change in the customer's activity, such as executing cross-border wire transfers for no apparent reason or a significant change in the volume of activity without explanation. It could also include information indicating a possible change in the customer's beneficial ownership, because such information could also be relevant to assessing the risk posed by the customer. These triggers may change the risk rating of the beneficial owner's account.

IMPORTANT DIFFERENCE FROM CURRENT CIP RULES:

Financial institutions were allowed to “grandfather” existing customers for the CIP rules that become effective October 11, 2003, if there was a reasonable belief that the true identity of the customer (member) was known. If the CIP policy and procedure for your credit union allowed this provision the new rules will require a revision to the policy and procedures.

The new rule does not require financial institutions to do an automatic or comprehensive look back to obtain beneficial ownership for existing legal entities. However, there will be a line in the sand beginning May 11, 2018, and unlike the CIP provisions there is NO “grandfather provision for existing members!

The requirements to certify and verify is TRIGGERED EACH TIME a legal entity (new or existing) opens a covered account, including loans.
EXAMPLE

Good Gumbo, Inc. has been a corporation in your state and long-time credit union member for 35 years. Bubba Breaux started the business and owns 50% of Good Gumbo, Inc. His sons, Buddy and Bobby, each have a 25% ownership interest and are running the business.

There are 17 existing loan and share accounts; some are business accounts and some are personal accounts. A lender, Billy Bob Breaux, handles the relationship and went to grade school, high school, and college with Bubba Breaux, the original owner of the company. CIP was done for Good Gumbo in November 2003 and for Bubba, Buddy, and Billy Bob for their personal accounts.

On May 30, 2018, Good Gumbo applies for a new loan to finance a franchise location in Alabama. Good Gumbo also opens a new deposit account for the franchise location.

WHAT IS REQUIRED?

(1) Billy Bob Breaux must obtain the beneficial ownership information in Appendix A (or a similar form) for the beneficial owners of Good Gumbo, Inc.

(2) Bubba Breaux owns 50%, Buddy owns 25%, and Bobby owns 25% of Good Gumbo, Inc – there are THREE beneficial owners.

(3) The information for EACH beneficial owner will include their names, addresses, their dates of birth and Social Security numbers (or passport number or other similar information).

(4) HOW could this be done? The rules allow Billy Bob to look at photo copies of their driver’s license records for the name, date of birth, and address; the W-9 certification from personal signature cards has their individual Social Security numbers.

(5) At least ONE person must be identified as having control of Good Gumbo. Buddy was made CEO at the most recent board meeting. Billy Bob has a copy of the board minutes and a corporate resolution.

(6) The required information must be completed for the NEW LOAN and for the NEW DEPOSIT ACCOUNT because the accounts are opened after May 11, 2018.

(7) Additionally, a person responsible for account opening must certify that the beneficial ownership information is correct. Mrs. Bella Breaux (Bubba’s wife and mother of Buddy and Billy) is the officer manager and opens the new deposit account. Bubba, Buddy, and Billy Bob are applicants for the loan and sign the loan documents and can be asked to certify the information for the new loan.
TRIGGERING EVENTS AND UPDATING INFORMATION

What are some examples of triggering events in the lending process?

- Reviews of internal reports for loans with an early payoff might cause communication with the borrower and the financial institution learns of a change in beneficial ownership.
- A borrower passes away and the credit union is notified by an attorney or family member about ownership changes.
- The loan becomes delinquent and a collector learns about an ownership change in response to the past due notice or phone call.
- The credit union is notified of a lapse in flood insurance payments and learns of an ownership change when the borrower of record is contacted.
- An existing loan member wants to extend the term of the loan and a change in ownership of a legal entity is discovered during this process.

What are some examples of triggering events with deposit (share) accounts?

- A member passes away and the credit union is notified by an attorney or family member about ownership changes.
- Requests are made to change signers on a deposit account for a legal entity.
- IRS levies or summons require notification and may prompt enhanced due diligence and prompt reevaluation of beneficial ownership.

FinCEN notes, however, that this provision does not impose a categorical requirement that financial institutions must update customer information, including beneficial ownership information, on a continuous or periodic basis. Rather, the requirement to update such information is event-driven and occurs as a result of normal monitoring.

FinCEN also noted that the requirements of the rule “represent a floor, not a ceiling, and, consistent with the risk-based approach, credit unions may do more in circumstances of heightened risk, as well as to mitigate risks generally.” In addition, regulators may themselves impose their own supervisory requirements on the institutions they examine.

These AML program amendments will apply to all legal entity deposit accountholders, including existing ones, as of May 11, 2018.
COMPONENTS OF AN EFFECTIVE CDD PROGRAM

The concept of Customer Due Diligence (CDD) begins with verifying the customer’s (member’s) identity and assessing the risks associated with that member. Financial institutions should also include Enhanced Due Diligence (EDD) for higher-risk members and ongoing due diligence of the member base.

Components of an Effective CDD Program
An effective CDD program should be designed to:

1. Gather information about the member;
2. Assess and mitigate the risks associated with the members;
3. Monitor accounts; and,
4. Evaluate activity to determine if it is unusual or suspicious.

Gather information about the member:
Regulators require that a Customer Information Program must contain risk-based procedures for verifying the identity of the member within a reasonable period of time after the account is opened (or prior to, if that is the financial institution’s policy). Establishing the accuracy of every element of identifying information is not required, but sufficient verification to form a reasonable belief of the true identity of the member is required. A financial institution’s procedures must describe when it will use documents or non-documentary methods (or a combination of both) to verify the information.

For covered financial institutions that may use documentary verification for their CIP procedures, the final beneficial ownership rule also clarifies that these institutions may use photocopies or other reproductions of documents required to be produced as part of ordinary CIP for individual members. FinCEN cautions, however, that “given the vulnerabilities inherent in the reproduction process, covered financial institutions should conduct their own risk-based analyses of the types of photocopies or reproductions that they will accept in accordance with this section, so that such reliance is reasonable.” See, FinCEN Preamble, p. 41.

Identifying information should be obtained at account opening, and as circumstances dictate, throughout the life of the relationship. The information should be sufficient to develop an understanding of the nature and purpose of the relationship as well as an effort to develop a “customer risk profile.” This understanding can be based on self-evident information, such as the type of customer/business, type of account opened, or the service/product used. Other relevant facts might include basic information, such as annual income, net worth, where the business is organized, or principal occupation or business. In the case of existing customers, it might also include the customer’s activity history. The Final Rule specifies that the customer risk profile may include a system of risk ratings or categories of customers, but this is not a requirement.
QUESTION: Does your financial institution have AML software that generates risk ratings? If yes, has the vendor announced pending changes to comply with the rules? If no, what changes should be made to the manual system for risk assessment?

This information, or customer risk profile, serves as a baseline against which customer activity can be evaluated for patterns and amounts of transactions that help with suspicious activity reporting. Ideally, the customer risk profile information can be integrated into automated monitoring systems and used to identify transactions that are not of within the range of expected activity. Ultimately, the information gathered through CDD can also be used to enhance SARs, which will help law enforcement and other authorities investigate and pursue illicit financial activity.

Assess and mitigate the risks associated with members

Although any type of account is potentially vulnerable to money laundering or terrorist financing, certain members and entities may pose specific risks just by the nature of their business activity, ownership structure, anticipated/actual volume and types of transactions, including transactions involving higher-risk areas. The BSA Exam Manual states, “it is essential to exercise judgment and neither define nor treat all members of a specific category of member as posing the same level of risk.” The Final Rule also expresses this. Care should be taken against profiling (targeting a group of people based on personal characteristics rather than behavior) and consider other variables when assessing risk, such as services sought and geographic locations.

Some members will have defined profiles specific to their risks and will be subject to more in-depth levels of monitoring, while others will have basic profiles subject to routine monitoring. Higher-risk members and their transactions should be reviewed more closely at account opening and more frequently throughout the term of their relationship with the financial institution. (See APPENDIX K in the next section for more details).

Higher risk member examples include:

- Non-Resident Aliens (NRA) and Foreign Individuals;
- Politically Exposed Persons (PEP);
- Embassy, Foreign Consulate and Foreign Mission Accounts;
- Non-Bank Financial Institutions (NBFI);
- Professional Service Providers; and multiple tiered accounts – Money Managers, Financial Advisors, Payable through accounts
- High-net-worth individuals (Private Banking)
- Non-Governmental Organizations (NGO) and Charities;
- Business Entities (Domestic and Foreign): and,
- Cash-Intensive Businesses.
If a financial institution determines that a member poses a higher risk, consideration should be
given to obtaining, both at account opening and throughout the relationship, the following
information on the member, as applicable based on the procedures for a higher-risk account:

- Purpose of the account;
- Source of funds and wealth;
- Individuals with ownership or control over the account, such as beneficial owners,
signatories, or guarantors;
- Occupation or type of business (of member or other individuals with ownership or
control over the account);
- Financial statements; banking references; and domicile (where the business is organized);
- Proximity of the member’s residence, place of employment, or place of business to the
financial institution;
- Description of the member’s primary trade area and whether international transactions
are expected to be routine;
- Description of the business operations, the anticipated volume of currency and total sales,
and a list of major members and suppliers; and,
- Explanations for changes in account activity.

FinCEN issued interagency guidance in March 2010 indicating that financial institutions identify
beneficial owners for members identified as having higher risk levels. Here is a link to FIN-
2010-G001: https://www.ffiec.gov/bsa_aml_infobase/documents/FinCEN_DOCS/FIN-2010-
G001.pdf

These were three potential CDD procedures for beneficial owners:

- Determining whether the member is acting as an agent for or on behalf of another, and if
so, obtaining information regarding the capacity in which and on whose behalf the
member is acting.
- Where the member is a legal entity that is not publicly traded in the United States, such as
an unincorporated association, a private investment company (PIC), trust or foundation,
obtaining information about the structure or ownership of the entity so as to allow the
institution to determine whether the account poses heightened risk.
- Where the member is a trustee, obtaining information about the trust structure to allow
the institution to establish a reasonable understanding of the trust structure and to
determine the provider of funds and any persons or entities that have control over the
funds or have the power to remove the trustees.

Monitor Accounts:
The FFIEC Manual mentions the importance of projecting account activity. The “fifth pillar” of
BSA compliance indicates a clear expectation for a “customer profile” which the preamble to the
new regulation described as: …the information gathered about a member to develop the baseline
against which member activity is assessed for suspicious transaction reporting.
Member accounts should be monitored on an ongoing basis to: 1) identify and report suspicious transactions; and, 2) maintain and update member information based on their risk.

Also, the requirement to update information, including beneficial ownership information of legal entity customers, is only triggered when the financial institution becomes aware of information about the member, in the course of normal monitoring, that is relevant to assessing or reevaluating the risk posed by a member.

Enhanced due diligence for higher risk members should include periodic risk-based monitoring of the member relationship to ensure account profiles are current and to identify any changes to the original CDD. Financial institutions should consider whether risk profiles should be adjusted or suspicious activity reported when the activity is inconsistent with the profile.

Some examples that would prompt an update to the member risk profile include:

- A significant and unexplained change in the member’s activity (i.e., executing cross-border wire transfers for no apparent reason);
- A significant change in the volume of activity without explanation;
- Information indicating a change in a legal entity customer’s beneficial ownership is a trigger in itself for updating the member risk profile.

NOTE: This applies to ALL legal entity customers, not just the new members as of the effective date (May 11, 2018).

Evaluate activity to determine if it is unusual or suspicious:
Risk-based monitoring efforts should include a review of expected vs. actual transactions and any unusual or suspicious activity. Refer to Appendix F: Money Laundering and Terrorist Financing “Red Flags” in the BSA Exam Manual for examples of potentially suspicious activities.

Financial institutions are required to file a Suspicious Activity Report (SAR) on any transaction conducted or attempted by, at, or through the financial institution, that:

- Involves or aggregates at least $5,000 in funds or other assets, and the financial institution knows, suspects, or has reason to suspect that:
  1. The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any Federal law or regulation or to avoid any transaction reporting requirement under Federal law or regulation;
  2. The transaction is designed to evade any requirements of 31 CFR Chapter X or of any other regulations promulgated under the Bank Secrecy Act; or,
3. The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

b) Criminal violations that:

1. Involve insider abuse in any amount;
2. Aggregate to $5,000 or more when a suspect can be identified; and,
3. Aggregate to $25,000 or more regardless of a potential suspect

Financial institutions may also voluntarily file a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation but whose reporting is not “required” by 31 CFR Chapter X.

SEE THE “MONITORING AND DUE DILIGENCE RED FLAGS FOR SUSPICIOUS ACTIVITY IN THE SUPPLEMENT; it is a portion of APPENDIX F from the BSA Exam manual.
What do we know NOW from the 2014 BSA Exam manual about Customer Risk, Due Diligence and Suspicious Activity Monitoring?

Appendix K of the FFIEC BSA/AML Exam Manual shows “Customer Risk versus Due Diligence and Suspicious Monitoring”

USE THIS RESOURCE TO DEVELOP INTERVIEW QUESTIONS AND WORKSHEETS.

**Customer Risk versus Due Diligence and Suspicious Activity Monitoring**

Certain customer relationships may pose a higher risk than others. This chart provides an example of how a bank may stratify the risk profile of its customers (see legend and risk levels). Because the nature of the customer is only one variable in assessing risk, this simplified chart is for illustration purposes only. The chart also illustrates the progressive methods of due diligence and suspicious activity monitoring systems that banks may deploy as the risk level rises. (See Observed Methods, below.)

**Observed Methods of Due Diligence and Suspicious Activity Monitoring:**

1. Customized transaction profile with tailored monitoring against transaction profile
2. Source of wealth statement, financial statement
3. Unique profile specific to products and services used by customer
4. Basic profile, generic threshold monitoring

**Legend:** Types of Customers / Accounts

1. Resident Consumer Account (CD, Savings, Time, CD)
2. Nonresident Alien Consumer Account (CD, Savings, Time, CD)
3. Small Commercial and Franchise Businesses
4. Consumer Wealth Creation (at a threshold appropriate to the bank’s risk appetite)
5. Nonresident Alien Offshore Investor
6. High Net Worth Individuals (Private Banking)
8. Offshore and Shell Companies

**Consumer accounts typically have the lowest risk.**
IMPORTANT NOTE FROM PREAMBLE (page 29421 of Federal Register): This commenter also expressed concern about subjecting all account relationships to the requirement to monitor to identify and report suspicious transactions, contending that this implied a uniform requirement for monitoring transactions that was inconsistent with the risk-based approach. Therefore, the commenter requested that FinCEN expressly articulate that ongoing monitoring be conducted pursuant to the risk-based approach. We clarify first that our expectation that all accounts be subject to ongoing monitoring does not mean that we expect all accounts to be subject to a uniform level of scrutiny. Rather, we fully expect financial institutions to apply the risk-based approach in determining the level of monitoring to which each account will be subjected. Thus, consistent with current practice, we would expect the level of monitoring to vary across accounts based on the financial institution’s assessment of the risk associated with the customer and the account. We also noted that all account relationships would be subject to this requirement merely to reflect the fact that all accounts must necessarily be monitored in some form in order to comply with existing SAR requirements, and not only those subject to the CIP rule.
## CIP Matrix

<table>
<thead>
<tr>
<th><strong>CIP for Deposit and Loan Members</strong></th>
<th><strong>CIP for Beneficial Owners</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Information:</strong></td>
<td><strong>Information:</strong></td>
</tr>
<tr>
<td>Name, Address, DOB, and TIN or EIN</td>
<td>Name, Address, DOB, and TIN or EIN</td>
</tr>
<tr>
<td><strong>Documents:</strong></td>
<td><strong>Documents:</strong></td>
</tr>
<tr>
<td>Driver’s license and Social Security card for individuals for a deposit account. Loan member would require a primary document and a consumer report Government-issued document – example articles of incorporation, partnership agreements, etc.</td>
<td>Driver’s license and Social Security card for individuals for a deposit account. May be a copy of the license, passport or other government issued ID. <strong>CHALLENGE</strong> – <em>There is no single source document that verifies the name and address from the driver’s license WITH the federal tax identification number of an individual who is a beneficial owner.</em> (This issue has been submitted to FinCEN – monitor FUTURE guidance for an answer). Loan member would require a primary document and a consumer report Government-issued documents, see examples; Appendix A or equivalent</td>
</tr>
<tr>
<td><strong>Nondocument:</strong></td>
<td></td>
</tr>
<tr>
<td>Third-party vendor and welcome letter</td>
<td></td>
</tr>
</tbody>
</table>

There was never a requirement that financial institutions apply the same standards to all products or account types in their CIP. Here are two CIP APPROACHES:

<table>
<thead>
<tr>
<th><strong>A deposit member might need</strong></th>
<th><strong>A loan member might need</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Two forms of documentary identification, one of which must be primary</td>
<td>One form of primary documentary identification and a consumer report</td>
</tr>
</tbody>
</table>

## Beneficial Owner Examples

<table>
<thead>
<tr>
<th><strong>If the owners are...</strong></th>
<th><strong>Then the member is a...</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders</td>
<td>Corporation</td>
</tr>
<tr>
<td>Partners</td>
<td>Partnership</td>
</tr>
<tr>
<td>Limited Liability Company</td>
<td>Member</td>
</tr>
</tbody>
</table>

## Note: Toolkit Resources
- SEE INTERVIEW QUESTIONS IN THE TOOLKIT FOR LEGAL ENTITIES AND
- CHECKLIST FOR IDENTIFYING LEGAL ENTITIES
- PROCEDURES TEMPLATE – GETTING READY TASKS
Due diligence procedures for existing accounts involves the review of standard reports looking for suspicious activities such as the presence of large amounts of currency, wire transfers to foreign countries etc. Those are facts that might suggest membership in one of the groups subject to expanded examination overview and due diligence.

**Possible sources of information are:**

Conventional reports, which may include:

- Accounts listed by risk or classification code or both,
- Average balance change,
- Check/debit volume change,
- Kiting suspects,
- Large dollar transactions,
- Loans with early pay off,
- Loans secured by cash equivalents,
- Many deposits, few checks,
- Significant balance changes,
- Account analysis,
- Electronic banking and electronic payment activity and
- Accounts with multiple alerts.
- Cash tracking reports which aggregate cash transactions affecting an entire CIF or related CIFs over long periods of time; e.g., weeks, months, etc.
- Rules-based anti-money laundering software, or
- Intelligent anti-money laundering software
DECISION POINTS AND TIMELINES

IMMEDIATE ACTION STEPS:

(1) Inform management about the extent of the changes and WHY they are being implemented. USE A SIMPLE HANDOUT. (The Credit Union National Association (CUNA) completed a Compliance Chart that outlined the new provisions; check with other trade associations where your credit union has membership and any information from YOUR primary regulator. This is a link to the NASCUS (The State Credit Union System), their Legislative and Regulatory Affairs Department prepared a final rule summary:

(2) Investigate the options currently available for using software and automation to assist with the verification, record retention, and risk profile aspects of the rules. Consult any applicable “user groups” for the existing data processing resources.

(3) LEARN the requirements of the rules. How will they “work” with the existing CIP program, as well as the CDD policy and related procedures?

Some of these elements should be considered in making decisions and establishing an implementation timeline. Other elements should be part of the existing and ongoing BSA program.

- Review effectiveness of CURRENT CIP documentation. Is it working?
- Can CDD documentation for beneficial ownership become automated? REMEMBER THAT THERE IS NO “GRANDFATHER” EXCEPTION FOR THE NEW BENEFICIAL OWNERSHIP RULES. It must be done EVERY TIME a legal entity account is opened on or after May 11, 2018. What controls will be required to make this happen?
- Look for triggering events on or after May 11, 2018, for members that had accounts prior to the effective date.
- Review the checklist for the Implementation Plan in the Toolkit
- Look for updated FAQs from FinCEN when they become available and review them carefully!
- Monitor any guidance from YOUR primary regulator. This guidance may impact the implementation plan and timeline.
- Exercise due diligence for account activity
- Monitor triggering events for changes in ownership that may require updates to EXISTING CIP documentation for deposit and loan records
- Report POTENTIAL suspicious activity to the BSA Officer
- Participate in periodic BSA training and make sure that new employees receive training
- GOOD LUCK!