

AML Challenges
A practical Guide to FinCEN's CDD Rule

FINRA Annual Conference
Washington, DC
May 2018

Practical Guide to the FinCEN CDD Rule

– Revised CIP Requirements

- Identification of **beneficial ownership** of **legal entity customers**
- **Ownership prong:** Verification of identity of these 25% (or more) beneficial owners (natural persons)
- **Control prong:** Identification and verification of a natural person who “controls” the entity (CEO, CFO, COO, President, VP, etc.)

– New “Fifth Pillar”

- FinCEN notes pre-existing guidance in this area
- Understand “nature and purpose” of customer relationships (*i.e., develop customer risk profiles as a baseline, and update customer information on a risk basis*)
- Conduct ongoing monitoring to identify and report suspicious transactions

Beneficial Ownership

The beneficial ownership requirement applies to legal entity customers. It applies to natural persons who own 25 percent or more of the equity interests of a legal entity customer.

- **Legal Entity Customers –**

“...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.” – 31 CFR 1010.230(e)(1)

- **Beneficial owner –**

*“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 a legal entity customer;” – 31 CFR 1010.230(d)(1) (**Ownership Prong**)*

-and-

*“A single individual with significant responsibility to control, manage, or direct a legal entity customer, including: an executive officer or senior manager...; or any other individual who regularly performs similar functions.” – 31 CFR 1010.230(d)(1) (**Control Prong**)*

Many Exclusions from “Legal Entity”

“Legal Entity Customers” definition does not include –

- A financial institution regulated by a Federal functional regulator or a bank regulated by a State bank regulator
- An issuer that is a reporting company under section 15(d) of the '34 Act
- An SEC registered investment company
- An SEC registered investment advisor
- An SEC registered exchange or clearing agency
- Any other entity registered with the SEC
- A CFTC registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, as defined in Section 1a of the Commodity Exchange Act
- A public accounting firm registered under SOX
- A bank holding company or savings and loan holding company
- A pooled investment vehicle operated or advised by a financial institution excluded from the definition of Legal Entity Customer
- An insurance company that is regulated by a State
- A FSOC financial market utility
- A foreign financial institution established in a jurisdiction where the regulator of that institution maintains beneficial ownership information regarding that institution
- A non-U.S. governmental department, agency, or political subdivision that engages only in governmental rather than commercial activities,
- Any legal entity to the extent that it opens a private banking account subject to 1010.620,
- Natural persons, sole proprietorships, unincorporated associations, and trusts (except statutory trusts).

Verification of Beneficial Ownership

- **Verification of beneficial owners** (ownership and control prongs) can be accomplished in the same manner as currently is the case, except that for purposes of the new rule, documentary verification can be accomplished using photocopies of the required document.
- **Reliance on Beneficial Ownership Information:** Financial institutions may rely on information supplied by the legal entity customer as to its beneficial owners unless it has knowledge of facts that would reasonably call into question the reliability of such information.
- **Beneficial Ownership Form Template:** FinCEN provides, as Appendix A to the rule, a certification form that may be used. Firms may use their own forms so long as the information provided is certified as complete and correct by the natural person opening the account.
- **Existing Customers:** The requirements apply to accounts opened after May 11, 2018, but firms will have to update customer information (including beneficial ownership information) if it detects “information relevant to assessing or reevaluating” the risk attributable to the customer.

The “Fifth Pillar” – Ongoing Due Diligence

- Appropriate risk-based procedures for conducting **ongoing customer due diligence**, to include, but not be limited to:
 - Understanding the **nature and purpose** of customer relationships for the purpose of developing a customer risk profile; and
 - Conducting **ongoing monitoring** to identify and report suspicious transactions and, on a risk basis, to maintain and **update customer information**. Customer information shall include information regarding the beneficial owners of legal entity customers.
- **Customer Risk Profile** may include such information as:
 - Type of customer
 - Account or service being offered
 - Customer’s income
 - Customer’s net worth
 - Customer’s domicile
 - Customer’s principal occupation or business
 - Customer’s history of account activity (existing customers)
 - May be “self-evident” for certain lower risk customers
 - Should be used to develop a “baseline against which customer activity, such as the customer’s expected use of wires or typical number of deposits in a month, can be assessed for possible suspicious activity reporting.” (FinCEN FAQ April 2018, at Q. 36)
- **Ongoing monitoring** – Updates to customer information may be “event driven”

Compliance with the FinCEN CDD Rule

A Framework.

Step 1

Assessment

- Consider impacts to various departments (include constituents from each)
- Review existing policies and procedures (CDD, risk assessment and suspicious activity monitoring)
- Gather information on current customer risk assessment capability
- Gather current forms and tools utilized for CIP and CDD
- Determine types of accounts (client relationships) affected
- Assess processes for ongoing verification and monitoring (including OFAC) and whether changes must be made to facilitate continued ongoing monitoring
- Assess current state of firm assessment of “nature and purpose” of customer and account

Step 2

Gap Analysis

- Determine whether existing systems and processes can satisfy requirements (*e.g.*, customer risk profile, suspicious activity monitoring, information systems, etc.)
- Ensure that new beneficial owner information will be screened against sanctions lists (OFAC)
- Determine whether to use the FinCEN form for CDD, or incorporate into existing forms
- Consider using FinCEN 25% threshold or lower threshold based on risk (*i.e.*, a lower threshold for higher risk clients)
- Consider changes to suspicious activity monitoring policies and processes – “nature of account” and identification of material deviations
- Consider changes to customer risk profile and overall risk assessment
- Determine factors critical to the development of a customer risk profile
- Consider FinCEN FAQs

Step 3

Implementation

- Consider starting with the FINRA Small Firm AML Template as a guide for new procedures
- Incorporate all aspects of the revised processes in the procedures – be specific as to tools, forms, etc.
- Implement changes to forms and systems
- Modify (or implement) customer risk profiling process and overall risk assessment as appropriate
- Implement desired changes to monitoring processes for suspicious activity monitoring, taking into account the firm’s approach to learning and monitoring “nature and purpose” of account
- Final procedures should be approved by senior management
- Deliver training related to changes to affected staff

Helpful Tools

- **FINRA Notice 17-40**: <http://www.finra.org/industry/notices/17-40>

- **FINRA Small Firm AML Template**

<http://www.finra.org/industry/anti-money-laundering-template-small-firms>

- **FinCEN CDD Rule**

<https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf>

- **FinCEN CDD Rule FAQ**

2016 FAQ: [https://www.fincen.gov/sites/default/files/2016-09/FAQs for CDD Final Rule %287 15 16%29.pdf](https://www.fincen.gov/sites/default/files/2016-09/FAQs%20for%20CDD%20Final%20Rule%2015%2016.pdf)

2018 FAQ: [https://www.fincen.gov/sites/default/files/2018-04/FinCEN Guidance CDD FAQ FINAL 508 2.pdf](https://www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf)

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