

Alert

FinCEN's ANPRM on Customer Due Diligence for Financial Institutions — Comments Due May 4

March 9, 2012

On March 5, 2012, the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Treasury Department ("Treasury"), issued an advanced notice of proposed rulemaking ("ANPRM") requesting input from various industries on customer due diligence ("CDD") requirements for financial institutions. Financial institutions that would be covered by this CDD rule would include banks, broker-dealers, mutual funds, futures commission merchants and introducing brokers in commodities ("covered financial institutions"). In addition, other industries such as money service businesses, including providers of prepaid access; insurance companies; casinos; dealers in precious metals, stones and jewels; non-bank mortgage lenders or originators; and other entities under FinCEN's regulations, may also be subject to this proposal in the future, even though they may not all be subject to the same AML requirements. FinCEN has requested that comments on these issues be received on or before May 4, 2012.

Elements of a CDD Rule

FinCEN believes that an effective CDD program includes the following elements:

- Conducting initial due diligence on customers, which includes identifying the customer, and verifying that customer's identity as appropriate on a risk basis, at the time of account opening;
- Understanding the purpose and intended nature of the account, and expected activity associated with the account for the purpose of assessing risk and identifying and reporting suspicious activity;
- Except as otherwise provided, identifying the beneficial owner(s) of all customers, and verifying the beneficial owner(s)' identity pursuant to a risk-based approach; and
- Conducting ongoing monitoring of the customer relationships and conducting additional CDD as appropriate, based on such monitoring and scrutiny, for the purposes of identifying and reporting suspicious activity.

FinCEN is proposing to codify the elements of a CDD rule, as follows:

Customer Identification and Verification: For the purposes of the customer identification program ("CIP") requirement, the definition of "customer" is the accountholder, regardless of whether the accountholder is also the beneficial owner. FinCEN is exploring an express customer identification and risk-based verification component of CDD, which does not create a new CIP obligation, but would be satisfied by compliance with the financial institution's current CIP obligations. Thus, consistent with the CIP requirements, covered financial institutions would be required to identify, and, on a risk basis, verify, the identity of each customer, to the extent reasonable, such that the institution can form a reasonable belief that it knows the true identity of each customer.

If a financial institution is compliant with its current CIP obligations, it would be compliant with this part of the CDD program rule, and, therefore, there would be no new or additional regulatory obligation.

Nature and Purpose of an Account: FinCEN is specifically considering including an express obligation to understand the nature and purpose of the account or customer relationship as an element of a CDD program rule. In this regard, covered financial institutions would be expected to understand the nature and purpose of the account and expected activity associated with the account for the purposes of assessing the risk and identifying and reporting suspicious activity. FinCEN notes that, although certain customers are exempt from the CIP requirements (i.e., the customers are currently excluded from the definition of “customer” for purposes of the CIP requirement), those customers would not be exempt from the requirements to understand the nature and purpose of the account and to conduct ongoing monitoring.

Beneficial Ownership Information: Except as otherwise provided (e.g., in existing regulation such as Section 312 of the USA PATRIOT Act of 2001), covered financial institutions may be required to identify the beneficial owner(s) of all customers, and verify the beneficial owners’ identity pursuant to a risk-based approach. FinCEN anticipates that it would provide additional guidance regarding customers that may be considered low risk (and therefore exempt for purposes of this beneficial ownership requirement), as well as identifying types of customers that may simply necessitate identification of the beneficial owner, and those that are of heightened risk requiring both identification and verification of the beneficial owner.

- **Definition of Beneficial Ownership:** FinCEN is considering a definition of “beneficial ownership” in the case of legal entities, which may include:
 - Either:
 - Each of the individuals who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity or otherwise, owns more than 25 percent of the equity interests in the entity; or
 - If there is no individual who satisfies the first prong, then the individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity or otherwise, has at least as great an equity interest in the entity as any other individual; *and*
 - The individual with greater responsibility than any other individual for managing or directing the regular affairs of the entity.
- **Potential Exemptions From the Beneficial Ownership Requirement:** FinCEN is considering whether legal entity customers that are exempt from identification as customers under the CIP rules should also be exempt from the beneficial ownership requirement. FinCEN recognizes that financial institutions may not have beneficial ownership information on existing customers, and is considering whether and how a potential beneficial ownership requirement would apply to existing customers of financial institutions. In this regard, FinCEN is considering a risk-based approach similar to that utilized in the case of the CIP rules, whereby this potential requirement would apply to all new customers. With respect to existing customers, FinCEN is seeking comment on how a beneficial ownership identification requirement could be phased into ongoing CDD.
- **Beneficial Owners of Assets in Accounts Held by Intermediaries:** The beneficial ownership requirement and potential definition of “beneficial owner” under consideration, as discussed above, are designed to identify the beneficial owner of a legal entity customer, as distinct from the beneficial owner of assets in an account. However, there may be instances in which obtaining information about the beneficial owners of assets in an account may be warranted instead, such as where a legal entity opens an account for the benefit of its customers as those customers could pose a money-laundering risk. FinCEN seeks comments on how financial institutions currently address the potential money-laundering risks presented by the beneficial owners of assets in an account pursuant to a financial institutions’ existing legal obligations and expectations under FinCEN’s regulations and related guidance, whether there are any issues or practical difficulties in doing so, and whether further guidance and rulemaking on this particular issue would be beneficial. FinCEN seeks comment on the difficulties associated with identifying beneficial owners of assets of such an account, and whether a potential explicit obligation to identify the beneficial owners of assets in an account should be based

on the financial institution's risk assessment of the customer, or whether a more specific obligation would be appropriate.

- *Customer Acting as Agent.* The question of beneficial ownership also arises in the context of an account established by an individual or entity, which could be acting on behalf of another individual or entity without disclosing this fact. A possible solution to this issue is to require the individual or entity opening the account at the financial institution to state that he, she or it is not acting on behalf of another person. For individuals or entities acting on behalf of another person, the beneficial ownership element of a CDD program requirement would apply to the person on whose behalf the account is being opened.
- *Verification of the Beneficial Owner.* The verification of the identity of the "beneficial owner" could have the following possible meanings:
 - Verification of the existence of the "beneficial owner" identified by the customer; or
 - Verification of the status of the "beneficial owner" identified by the customer, to confirm that the individual "beneficial owner" is indeed the "beneficial owner" of the customer.

In any event, such procedures must be reasonable and practicable, and sufficient to form a reasonable belief that the financial institution knows the identity or status of the beneficial owner.

Ongoing Account Monitoring: According to FinCEN, due diligence is an ongoing obligation and covered financial institutions should have in place policies and procedures to maintain the accuracy of their customer risk profiles and risk assessments. Financial institutions should update CDD information as necessary based on the overall risk of the customer, and may need to update or conduct additional CDD in association with specific events that would result in material changes in a customer's risk profile, such as volume of alerts or red flags relating to the account, change in control, change in occupation or account purpose, or the occurrence of a transaction or activity that is unusual for the customer.

Consistent with its suspicious activity reporting requirements, covered financial institutions would be required to establish and maintain appropriate policies, procedures and processes for conducting ongoing monitoring of all customer relationships, and additional CDD, as appropriate, based on such monitoring for the purpose of the identification and reporting of suspicious activity.

This potential element of an ongoing CDD monitoring rule is, in FinCEN's view, included in the requirements contained in the AML program and SAR rules, and therefore FinCEN does not view this as a new requirement.

Issues for Comment

FinCEN is interested in better understanding the types of CDD information that are currently collected, specifically in relation to beneficial ownership information, and under what circumstances the information is collected. FinCEN is seeking comment from industry and other interested parties concerning the implementation of CDD programs, on the following issues:

- Aside from policies and procedures with respect to beneficial ownership, what changes would be required in a financial institution's CDD processes as a result of the adoption by FinCEN of an express CDD rule?
- Aside from beneficial ownership, FinCEN believes that the other elements of a potential CDD rule are already being implemented by a substantial number of financial institutions.
 - What changes would be required in a financial institution's CDD process, as a result of the adoption by FinCEN of a categorical requirement to obtain (and in some cases verify) beneficial ownership information?
 - Is FinCEN's suggested alternate definition of "beneficial owner" a clear and easily understood definition for the purpose of obtaining beneficial ownership information for legal entities in the context of complying with a CDD obligation?

- How do financial institutions currently address the money-laundering risks that might be presented by the beneficial owners of assets in an account held by an intermediary? What difficulties are presented in this regard? Would further guidance or regulation be appropriate?
- Should any requirement in this area be risk-based and how should FinCEN define beneficial ownership for this purpose?
- Under what circumstances does a financial institution currently obtain beneficial ownership information on a customer or accountholder?
- How do financial institutions currently obtain beneficial ownership information?
- What information should be required in order to identify, and verify on a risk basis, the identity of the beneficial owner?
- Is the current, primarily risk-based, approach to a CDD program requirement resulting in varied approaches across industries or varied approaches within industries?
- Are there other elements of CDD that would be more effective in facilitating compliance with AML program requirements and other obligations under FinCEN's regulations?
- Are there any products and services, or customers that should be exempted from the requirement to obtain beneficial ownership information due to there being:
 - Substantially less risk of money laundering or terrorist financing associated with the account?;
 - Limited value associated with the beneficial ownership information in mitigating money-laundering/terrorist-financing risk?; or
 - An inability to obtain the required information due to other legal requirements?
- What financial institutions should not be covered by a CDD rule based on products and services offered?
- What would be the impact on consumers or other customers of a CDD program?

Authored by [Betty Santangelo](#) and [William I. Friedman](#).

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

New York

Schulte Roth & Zabel LLP
 919 Third Avenue
 New York, NY 10022
 +1 212.756.2000
 +1 212.593.5955 fax

Washington, DC

Schulte Roth & Zabel LLP
 1152 Fifteenth Street, NW, Suite 850
 Washington, DC 20005
 +1 202.729.7470
 +1 202.730.4520 fax

London

Schulte Roth & Zabel International LLP
 Heathcoat House, 20 Savile Row
 London W1S 3PR
 +44 (0) 20 7081 8000
 +44 (0) 20 7081 8010 fax

www.srz.com

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