FinCEN Issues Updated Guidance Regarding Customer Due Diligence Requirements for Financial Institutions

**Overview:** The Financial Crimes Enforcement Network (“FinCEN”) has released updated Frequently Asked Questions (“FAQs”) to assist covered financial institutions in understanding the scope of the Customer Due Diligence Requirements that institutions must comply with as of May 11, 2018 (“CDD Rule”). The CDD Rule, issued in 2016 and amended in 2017, establishes new standards under the Bank Secrecy Act (“BSA”) requiring covered financial institutions to establish policies to identify and verify their customers’ beneficial owners (those who own more than 25 percent in the entity) and to develop customer risk profiles. According to FinCEN, the more explicit standards will help covered institutions better understand who their customers are and what transactions they are conducting to more effectively combat illicit activity, such as terrorist financing and money laundering, perpetrated via shell companies and the like.

In 2016, FinCEN issued FAQs that addressed which institutions were covered, defined what constitutes a beneficial owner, and provided certain exemptions. The new 2018 FAQs address a wide range of topics relating to application of the CDD Rule, with a focus on beneficial ownership issues, such as threshold adjustments, identification and verification requirements in specific circumstances, and definitional exclusions and exemptions. Notably, the FAQs specify when a covered institution may rely on, and use, previously collected beneficial ownership information, which may help reduce compliance burdens. Key features of the 2018 FAQs include the following:

- **Threshold Adjustments:** Covered financial institutions may implement more stringent thresholds and stricter internal policies and procedures for the collection of beneficial ownership information than required. (For example, an institution may collect and verify information on individuals who own less than 25% equity interest in a legal entity customer). Based on a covered institution’s own risk assessment of a customer, there may be circumstances where lower thresholds should be implemented, but other risk mitigation means, such as enhanced monitoring or collecting additional information, might be sufficient and will depend on the institution’s reasonable conclusion based on the facts of a particular circumstance.

- **Collection Requirements:** Customers must certify the beneficial owners for “new accounts” using the same criterion outlined in the Custom Identification Program (“CIP”) rule. Covered institutions are not required to conduct retroactive reviews to obtain such information for accounts that were opened prior to May 11, 2018.
  - **Existing Customers:** If the beneficial owner of a new legal entity account is an existing customer subject to CIP, the covered institution may rely on the...
information it already possesses to fulfill the beneficial ownership requirements, provided that the information is confirmed to be up-to-date and accurate.

- **Financial Products/Services:** For financial products and services (e.g. loan renewals and certificate of deposit (“CD”) rollovers) tied to existing accounts, the first loan renewal or CD rollover after May 11, 2018 is considered a “new account” subject to the CDD Rule. However, a covered institution need not collect beneficial ownership information for each subsequent renewal/rollover if the information is confirmed by the customer to be up-to-date and accurate.

- **Verification Procedures:** The procedures that covered institutions use to verify the identity of beneficial owners must contain, at a minimum, the same elements financial institutions are required to use for verification under applicable CIP requirements, but need not be identical. A risk-based analysis is necessary to determine the appropriate method(s) and types of documents appropriate for verification. Unlike CIP, copies of documents instead of originals are sufficient under the CDD Rule.

- **Monitoring and Updating:** Once the covered institution has collected and verified beneficial ownership information, the obligation to update that information is only triggered if normal monitoring or risk assessments indicate that such information has changed. Identification and verification requirements are the same for both “new accounts” and also triggering events. Where updates are required, the nature of the change will dictate whether the information needs to be re-certified; in most cases, the same or similar written processes the institution uses to record new account information will suffice. For example, it may be reasonable for an address change to be confirmed by the customer and updated internally, whereas a change of ownership would require collection, certification, and verification of the new owner’s information.

- **Record Retention:** Covered institutions must retain identifying information for five years after a legal entity’s account is closed, and verification records for five years after the record is made. Thus, if an institution is relying on pre-existing information when it opens a new account, all original records must be maintained for five years after the new account is closed. In addition to original records, a covered institution must also retain for five years after the record is made: (i) a description of every document it relied upon for verification, (ii) any verification methods, measures, and results; and (iii) the resolution of any substantive discrepancies discovered during identification or verification.

- **Definitional Exclusions, and Exemptions:** Generally, covered institutions may rely on the representations provided by customers as to whether a type of entity is excluded from the collection and verification requirements, provided that the institution has no knowledge of facts in a specific case that would reasonably call into question the reliability of the information. The institution’s policies and procedures should state the information the institution will obtain and rely upon to determine eligibility for exclusions. The FAQs also clarify the following regarding exclusions and exemptions:
  - Sole proprietorships and other unincorporated associations are not considered legal entity customers for which beneficial ownership information must be collected.
  - Foreign financial institutions are similarly exempted, as long as a foreign regulator collects and maintains beneficial ownership information on the entity (and regardless of whether the foreign regulator’s requirements are as stringent as those in the U.S.).
  - The exclusions set forth in the CDD Rule for a charity, non-profit, or similar entity apply to any such entity validly organized with the proper State authority, regardless of whether it meets the Internal Revenue Code definition for a charity or non-profit.

- **Other Key Provisions:** The FAQs also clarify who is considered the beneficial owner of pooled investment vehicles and trusts and specify what information a covered institution must collect for each type of account in various circumstances. Additionally, the FAQs end speculation regarding whether the CDD Rule affects Currency Transaction Reporting (“CTR”) compliance (it does not). Multiple businesses that share a common owner do not have to aggregate the currency transactions of the businesses for CTR reporting, except in the narrow instance where a covered institution has a reason to believe the businesses are not operating independently.
Outlook: The FAQs address many outstanding questions that covered institutions and industry groups had about the CDD Rule, and FinCEN may issue further guidance in the coming days. Additional guidance can already be found in the Federal Financial Institutions Examination Council’s May 2018 release of the CDD and beneficial ownership sections of its forthcoming BSA/AML Examination Manual update. Covered institutions should not only comply with the CDD Rule’s technical requirements, but also consider whether a customer’s ownership structure appears appropriately tailored in size and complexity for its business, whether it makes sense for an entity to seek a relationship with the institution, and the circumstances under which the entity is seeking that relationship (e.g. is it doing so voluntarily). This holistic approach will not only help ensure compliance with the CDD Rule’s core goals but also the efficient expenditure of a covered institution’s resources for compliance purposes.

Craig Saperstein, a member of NACHA’s Government Relations Advisory Group, is an attorney in the Public Policy practice of Pillsbury Winthrop Shaw Pittman LLP in Washington, D.C. In this capacity, he provides legal analysis for clients on legislative and regulatory developments and lobbies congressional and Executive Branch officials on behalf of companies in the payments industry. Deborah Thoren-Peden is a partner and member of the Financial Institutions Team at Pillsbury Winthrop Shaw Pittman LLP. She provides advice to financial institutions, bank and non-bank, and financial services companies. Andrew Caplan is an associate and member of the Financial Institutions Group and the Privacy, Data Security, and Information Use Focus Team at Pillsbury Winthrop Shaw Pittman LLP. He counsels and defends financial institutions, technology companies, and other clients that offer consumer products or services on a range of issues related to credit, payments, data privacy, cybersecurity, and e-commerce. The information contained in this update does not constitute legal advice and no attorney-client relationship is formed based upon the provision thereof.