

KEY POINTS

- The proposed rule's customer due diligence requirements fit within the US Bank Secrecy Act/Anti-Money Laundering framework.
- The beneficial ownership requirement of the proposed rule, if adopted in final form, would to an extent align US customer due diligence mandates with the beneficial ownership provisions of the FATF recommendations, as revised in 2012.
- If adopted in final rule form, the proposed rule will take effect as a final rule one year after its effective date.

Author Hdeel Abdelhady

Proposed US rule requires banks to collect beneficial ownership information

The Financial Crimes Enforcement Network (FinCEN) has issued a proposed rule intended to clarify and codify financial institution obligations to identify and verify individual customer identities, conduct ongoing monitoring, and understand the nature and purpose of customer relationships. Significantly, the proposed rule also introduces a new requirement that financial institutions identify the beneficial owners of legal entity account holders. If adopted in final rule form, the proposed rule will come into force one year after its effective date. This article discusses some of the beneficial ownership requirements of the proposed rule.

The Financial Crimes Enforcement Network (FinCEN), a bureau within the US Department of the Treasury tasked with combating money-laundering and other illicit uses of the financial system, has issued a proposed rule that clarifies and systematises customer due diligence (CDD) program requirements for certain financial institutions (the proposed rule). (Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45,151 (proposed 4 August 2014)).

The proposed rule, developed by FinCEN in consultation with federal functional regulators (eg, the Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation, Securities and Exchange Commission), enumerates four CDD elements:

- (1) customer identification and verification;
- (2) identification and verification of beneficial owners of legal entity customers;
- (3) understanding the nature and purposes of customer relationships; and
- (4) conducting ongoing monitoring to maintain and update customer information, and identify and report suspicious transactions.

The proposed rule applies only to Covered Financial Institutions (CFIs) that are subject to existing Customer Identification Program (CIP) requirements: (i) banks; (ii) securities brokers or dealers; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers.

FinCEN has expressed "continued interest" in "potentially extending" the proposed rule to additional entities, such as casinos, money services businesses and insurance companies. (proposed rule at 45,155). If issued in final form, the proposed rule would take effect one year from the date of the issuance of the final rule (*ibid* at 45,164).

RULEMAKING BACKGROUND

The proposed rule is not a final, binding rule. In the context of the US federal administrative rulemaking process, a notice of proposed rulemaking serves both to notify the public and key constituencies of a federal agency's intent to issue a final, binding rule and invite public (specifically industry) comments that, in principle, will be considered and reflected in any final rule (as practicable and consistent with regulatory purpose and authority).

In the case of the proposed rule, it is a continuation of a rulemaking process that began in 2012, with the publication by FinCEN of an advance notice of proposed rulemaking and subsequent public hearings with financial services industry participants. (Customer Due Diligence Requirements for Financial Institutions, 77 Fed. Reg. 13,046 (advance notice of proposed rulemaking 5 March 2012); see, eg, Summary of Public Hearing: Advance Notice of proposed rulemaking on Customer Due Diligence (5 October 2012), see www.fincen.gov/whatsnew/pdf/20121130NYC.pdf).

Given the relevant rulemaking history, industry engagement and the prior pronouncements of FinCEN and federal functional regulators on beneficial ownership that have preceded the proposed rule, it is reasonable to expect – but it is not certain – that a final rule will materialise substantially in the form of the proposed rule. (A notable prior pronouncement on beneficial ownership was jointly issued by FinCEN and functional financial regulations (eg, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve, the Securities and Exchange Commission) on 5 March 2010 (Joint Release, Guidance on Obtaining and Retaining Beneficial Ownership Information, see www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-g001.pdf)).

US BSA/AML CONTEXT

The proposed rule fits within the US Bank Secrecy Act/Anti-Money Laundering legal and regulatory framework, which imposes on financial institutions certain obligations to gather, verify, document, retain, and report in some instances (eg, in connection with suspicious activities, certain currency transactions) information about customers and transactions. "Bank secrecy" in the US legal and regulatory context, facilitates disclosure, it does not afford secrecy. (Bank Secrecy Act commonly refers to The Currency and Foreign Transactions Reporting Act of 1970 (and its progeny), the "principal purpose [of which was] to furnish American law enforcement...with the tools necessary to cope with the problems created by so called secrecy jurisdictions."). (HR REP. NO. 975 (1970).

PROPOSED RULE CDD ELEMENTS

According to FinCEN, the CDD elements (or "pillars"), with the exception of the beneficial ownership requirement, are consistent with existing CIP regulatory frameworks. (The proposed rule "amend[s] FinCEN's existing rules

Feature

Biog box

Hdeed Abdelhady is a Washington DC-based lawyer and founder and principal of MassPoint Legal and Strategy Advisory PLLC, a boutique law and strategy firm. She has served as secondment counsel (on transactional and compliance matters) to banks in Washington DC and in Dubai, and has cross-practice experience in banking and finance (conventional and Islamic), regulatory compliance and investment. Email: habelhady@law.gwu.edu

so that each of the pillars is explicitly referenced in a corresponding requirement within the FinCEN's program rules." (*Ibid* at 45,152). FinCEN has emphasised that "nothing in th[e] proposal is intended to lower, reduce, or limit the due diligence expectations of the federal functional regulators or in any way limit their regulatory discretion" (proposed rule at 45,152).

BENEFICIAL OWNERSHIP ELEMENT Regulatory scope and effect

The beneficial ownership requirement of the proposed rule, if implemented as proposed, will appear as a new section of FinCEN's regulations (as Beneficial ownership requirements for legal entity customers at § 1010.230 of Title 31 of the Code of Federal Regulations (CFR) (proposed rule at 45,170). Under the new section, a CFI would be required to have in place CDD procedures that enable it to "verify the identity of each beneficial owner identified to the financial institution, according to risk-based procedures to the extent reasonable and practicable" (*ibid*). The beneficial ownership rule sets forth "minimum standards" (*ibid* at 45,156) (emphasis in original)).

Legal entities, meaning

Legal entities under the proposed rule include corporations, limited liability companies, partnerships or other similar business entities formed under the laws of a US state or a foreign jurisdiction; general partnerships or unincorporated non-profit associations; all entities formed by filing with a secretary of state or equivalent office of a US state; and, trusts created through a filing with a state (such as a statutory business trust) (other trusts are excluded) (*ibid* at 45, 159). Consistent with existing CIP requirements, certain entity types (eg, domestic government agencies, publicly held companies traded on certain US stock exchanges) will be exempt from the new beneficial ownership requirement (*ibid* at 45,159, 45,170-171).

Applies only to new accounts

The beneficial ownership element will apply on a forward basis; CFIs will not be required to look back to identify the beneficial owners of previously opened legal entity customer accounts. However, FinCEN has stated its intention to *not exempt* existing legal entity customers that

open new accounts following the implementation of the final rule (*ibid* at 45,159 & n. 31). Thus, the parallel definitions of "customer" that appear in the rules applicable to banks and brokers or dealers and which define "customer" as "a person that opens a new account", will not be mirrored in the beneficial ownership element. (See definition of "customer" at 31 CFR § 1020.100 (banks) and 31 CFR § 1023.100 (brokers or dealers)).

Suggestively, FinCEN has stated that while it is "not proposing a prescriptive rule requiring financial institutions to look back and obtain beneficial ownership information for pre-existing accounts, we [*FinCEN*] are aware that, as a matter of practice, financial institutions may also consider identifying beneficial owners of existing customers when updating information on a risk basis" (proposed rule at 45,160) (emphasis added). FinCEN's language indicates an unsurprising preference for more than minimal compliance. In any case, CFIs may need to look back at pre-existing accounts to conduct ongoing monitoring and updating, an eventuality that is discussed in the proposed rule and is a predictable upshot of ongoing monitoring requirements and supervisory expectations.

Beneficial ownership, meaning

Under the proposed rule, CFIs will be required to identify each natural person (not legal entity) who: (1) "directly or indirectly...owns 25% or more of the equity interests of a legal customer"; and (2) a "single individual with significant responsibility to control, manage, or direct a legal entity customer, including...an executive or senior officer...[eg, CEO, general partner, treasurer]... or any other individual who regularly performs such functions" (*ibid* at 45,170). The identity of each beneficial owner identified to the CFI must be verified, in accordance with existing CIP minimum standards and risk based approaches (as under, eg, the Customer Identification Programs for banks provision at 31 CFR § 1020.220). Notably, the proposed rule does not require CFIs to also verify the status of the identified beneficial owner(s) *vis-à-vis* the legal entity customer (*ibid* at 45,156).

Mandatory certification of beneficial ownership, standard form

In response to industry feedback to the March 2012 advance notice of proposed rulemaking

on customer due diligence, the proposed rule requires CFIs to obtain, at the time a new legal entity account is opened, a certification of beneficial ownership (certified by the individual opening the account on the legal entity's behalf). The certification form, which is provided in an Appendix to the proposed rule, is mandatory (*ibid* at 45,162, 45,170, Appendix A). The entire proposed rule is available at www.fincen.gov/statutes_regs/files/CDD-NPRM-Final.pdf. FinCEN expects the standard certification form will promote uniformity of practices and regulatory expectations, and reduce the compliance burden for CFIs (*ibid* at 45,162).

Creation and retention of records

CFIs will be required to implement procedures for maintaining records of "all information obtained in connection with identifying and verifying" beneficial owners, including retaining the mandatory certification form and "any other related identifying information collected" (*ibid* at 45,165). Additionally, records will be required to include descriptions of "every document relied on for verification... any non-documentary methods and results of measures undertaken...and...the resolution of any substantive discrepancies discovered in verifying the identification information" (*ibid*). Effectively, these requirements facilitate the creation of records that will be useful not only for identifying illegal or suspicious conduct by customers, but also for measuring the quality of CFI compliance programs in the context of CFI self-assessment and regulatory supervision and enforcement.

CFIs will be required to retain beneficial ownership and related verification records for five years after the date an account is closed and five years after an account is opened. ■

Further reading

- Corporate transparency and fraud: People in glass houses? [2013] 10 *JIBFL* 624.
- The devil is in the detail: the Fourth Money Laundering Directive in practice [2014] 5 *JIBFL* 308.
- Lexis PSL: Banking & Finance: Anti-money laundering in 19 jurisdictions worldwide.