

# Understanding FinCEN's Customer Due Diligence (CDD) Final Rule



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In the past, the absence of stringent requirements for financial institutions to identify (and verify the identity of) beneficial owners of entity customers allowed opportunity for illicit exploitation of the financial industry by means of anonymity.

Recently, this issue was highlighted by the Panama Paper scandal, which leaked approximately 11 million documents, including the financial information of more than 200,000 offshore entities. By obscuring their identities under the camouflage of legal entities, individuals were able to hide assets.

In May of 2016, the US Department of the Treasury announced a Customer Due Diligence (CDD) Final Rule and proposed Beneficial Ownership legislation in an effort to increase transparency in the financial industry and reduce instances of financial crime and illicit activity.

The Final Rule handed down from FinCEN has introduced risk-based CDD requirements to be combined with existing expectations relating to suspicious activity reporting requirements, as detailed below.

## CDD Final Rule: Four Central Principles

The rule outlines four elements of Customer Due Diligence (CDD):

- A. Customer identification and verification
- B. Beneficial ownership identification and verification for legal entity customers
- C. Understanding the nature and purpose of the customer relationship and subsequently developing a customer risk profile
- D. Ongoing monitoring

## Current AML Programs Likely Include 3 of the 4 Principles

A well-designed AML program should already include three of the four principles of the rule. Regulators currently expect that financial institutions obtain customer information at account inception, compose a customer risk profile, and use this profile during ongoing monitoring in order to identify potential red-flags.



## Five Things Financial Institutions Should Remember when Updating AML Procedures

Financial institutions have until May 11, 2018 to implement suitable policies and procedures to ensure compliance with the rule. When designing and implementing procedures surrounding the collection of information relating to Ultimate Beneficial Owner (UBO) information, AML compliance professionals should consider the following:

### 1. Identification and Verification

The rule requires that financial institutions gather information at account inception that will allow the identification of individuals who own and or control legal entity customers. The identity of these individuals must be confirmed (government-issued ID's are generally acceptable forms of verification).

### 2. Ownership and Control

**Ownership:** Any individual(s) who directly or indirectly own(s) 25 percent or more of the equity interests in the legal entity must be identified. This means that up to four individuals may be identified; however, there may not be any individual identified (i.e., if no individual owns 25 percent or more).

**Control:** At least one individual **must** be identified who exercises significant managerial control over the legal entity customer (executive officers, senior managers, etc.) An individual identified under the ownership component noted above may also be identified in this area.

### 3. Exemptions

The rule contains various exclusions. The list of excluded legal entity types includes sole proprietors and unincorporated associations, as, typically, entities like this do not have a legal presence separate from the associated individual that could facilitate the concealment of their identity.

### 4. Certification Form

A certification form exists which outlines UBO information that must be collected from each applicable legal entity customer; the use of this form is optional. Required UBO information may be obtained, per the rule, "by any other means that comply with the substantive requirements of this obligation... provided the individual certifies, to the best of the individual's knowledge, the accuracy of the information."

### 5. Updating UBO Information for Existing Customers

When a new or existing legal entity customer opens a new account, UBO information must be collected; however, there is no requirement to obtain or update UBO information for existing legal entity customers, however, implementing a process to review and update this information should be considered a best practice.



Additionally, there is no requirement to update this information. FinCEN does expect that UBO information should be monitored via normal review procedures and updated if/when information is identified that is relevant to the customer's risk profile. Again, financial institutions should consider implementing a process to review and update this information on a regular basis.

### Conclusion

Prior to the implementation of the CDD Final Rule, the ability for individuals to hide financial activity through anonymous ownership of legal entities was an obvious notch in the shield designed to prevent financial crime. In taking steps to gain a more complex profile of entity customers, financial institutions can take a risk-based approach to reducing the introduction of criminal or otherwise prohibited funds into the US financial system.

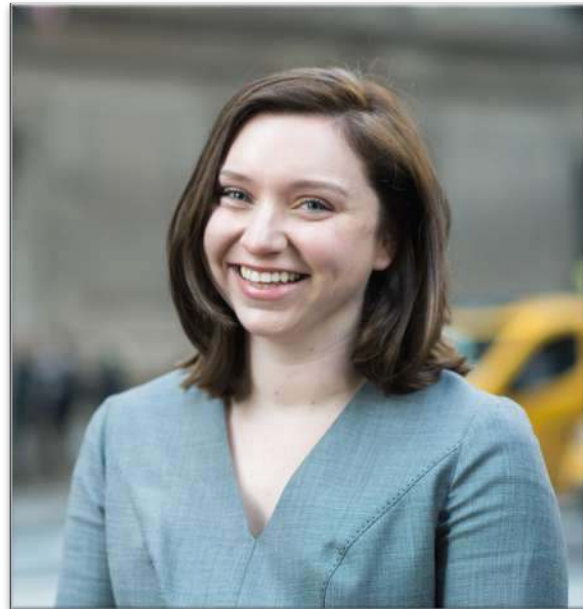
The CDD Final Rule is a move toward increased financial transparency- a growing trend for regulatory bodies in 2018.



## **ABOUT THE AUTHOR: KAITLYN GIBBS**

Kaitlyn Gibbs joined CRC in 2017. She is a regulatory compliance professional with 7 years of experience in the financial services industry. Kaitlyn has extensive knowledge of the rules of the Investment Company Act of 1940 and the Investment Advisers Act of 1940. She previously managed compliance processes and performed forensic testing in her role as Compliance Analyst at Welch & Forbes LLC.

She has experience performing annual reviews and risk analyses, regulatory research, as well as Code of Ethics administration. Her primary focus areas include, process implementation and enhancement, cybersecurity, marketing materials review, private equity investment compliance, and investment portfolio compliance.



Most recently at CRC, Kaitlyn has performed regulatory research, evaluated compliance programs, and performed annual reviews and risk assessments for investment advisors.

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