WHITE PAPER:

FinCEN Final Rule

INTRODUCTION

FINCEN FINAL RULE

Until recently, financial institutions did not have clear guidelines as to the requirements of identifying beneficial owners of legal entity customers.

This gap enabled criminals and suspicious characters the ability to keep their proceeds hidden in the financial system. This lack of information makes it difficult for institutions to accurately assess levels of risk, as these individuals were able to hide illegal proceeds under layers of ownership. The unclear framework also created an uneven playing field across and within financial sectors, with disparities in customer identification practices. However, recent events have brought to the spotlight the implications of having limited or minimal information on beneficial owners of an account.

THE PURPOSE OF THE FINAL RULE

On May 6, 2016, the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") published a final rule under the Bank Secrecy Act ("BSA") to codify new customer due diligence ("CDD") requirements. The new rules amend 31 CFR Parts 1010, 1020, 1023, 1024 and 1026. The new rule can be accessed here. The Final Rule became effective 60 days after its publication in the Federal Register; however, covered financial institutions will have a two year implementation period to comply with the new requirements. In conjunction with the release of the Final Rule, the White House announced a series of related legislative and regulatory initiatives aimed at increasing financial transparency and combatting corruption in the wake of the Panama Papers.

The new final rule from FinCEN attempts to level the playing field and close the gaps by clarifying and strengthening customer due diligence requirements for "covered institutions" which are identified as banks; brokers or dealers in securities; mutual funds; futures commission merchants and brokers in commodities.

BENEFICIAL OWNERS

The Final Rule creates a new § 1010.230 in Title 31 C.F.R requiring covered financial institutions prospectively to identify and verify the identity of beneficial owner(s) of each legal entity customer when a new account is opened. Beneficial owners are persons meeting either the "ownership prong" or the "control prong" of the definition of "beneficial owner." Under the ownership prong, a beneficial owner is each individual (if any) who, directly or indirectly, owns 25 percent or more of the equity interests of a legal entity customer. Under the control prong, a beneficial owner is a single individual with significant responsibility to control, manage or direct a legal entity customer, including (i) an executive officer or senior manager (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President or Treasurer) or (ii) any other individual who regularly performs similar functions.Responding to industry concerns about the burden of applying the new requirement to existing customers, the rule does not apply retrospectively. However, FinCEN confirmed that the requirements must be met for each new account opened after the rule goes into effect, which means covered financial institutions must obtain beneficial ownership information from pre-existing customers that open new accounts after promulgation of the rule.

Financial institutions will not be categorically required to gather beneficial ownership information for accounts established before the Applicability Date. In other words, the rule will only apply to accounts opened on or after such date. However, FinCEN has stated that it expects financial institutions to obtain beneficial ownership information for pre-existing accounts, when in the course of their normal monitoring, institutions detect information relevant to assessing or reevaluating an account's risk. Such information could include, for example, a significant and unexplained change in customer activity. Although FinCEN only expects monitoring-triggered updates of beneficial ownership information, institution would be wise to consider taking advantage of CDD refreshers to collect or update, on a risk-basis, beneficial ownership information for both pre-existing and new accounts. The risk-mitigating benefits of adopting this practice would far outweigh the associated costs.

LEGAL ENTITY CUSTOMER

The Final Rule defines "legal entity customer" as 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. Such definition includes limited partnerships and business trusts that are created by a filing with a state office. Legal entity customers do not include sole proprietorships, unincorporated associations, trusts (other than statutory trusts that are created through a state filing) or natural persons opening accounts on their own behalf.

CUSTOMER DUE DILLIGENCE

FinCEN's new "fifth" pillar will require all covered financial institutions to (i) understand the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and (ii) conduct ongoing monitoring to identify and report suspicious transactions and, on a risk-basis, maintain and update customer information. In the past, these two elements were implicitly required in connection with an institution's suspicious activity reporting obligations. Institutions will want to consider updating their policies to reflect these requirements explicitly, if that is not yet the case, and ensuring that their existing processes are designed to satisfy these obligations.

CHALLENGES FACING FINANCIAL INSTITUTIONS

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The new requirements from FinCEN encompass additional challenges as well. According to FinCEN's analysis, this is a significant regulatory action because it is likely to result in a final rule that may have an annual effect on the economy of $100 million or more. The direct effect to financial institutions will include time and resources spent understanding the Rule and its implications to the institution's business model; amending policies, procedures and forms; updating customer intake and maintenance systems; updating and delivering training on the new requirements; adding new categories to the cash aggregation and transaction monitoring systems; additional funding for expanded audits; etc. There will also be other interpretation and compliance challenges as well, like determining the level of reliance on information provided by the customers, impact of the Rule on existing customers, examiners expectations depending on the institution risk profile, and the implications of this Rule to other compliance requirements like CTR aggregation, Sections 314(a) and (b) inquiries and OFAC screening thresholds.

The inadequacy or absence of adequate CDD information on customers and related parties can subject financial institutions to serious risks, especially reputational, operational and legal risks. All these risks are interrelated. However, anyone of them can result in significant financial costs to financial institutions.

The regulatory impact will be tougher for financial institutions with weak AML compliance systems. As BSA exams have become more rigorous and focused in recent years, digging deeper into processes, systems and controls, any institution with deficiencies will be met with tougher monetary penalties and extensive burdens for systems improvements and additional personnel.

ACTION REQUIRED

The time to act is now. It is recommended that financial institutions conduct continuous self-assessments against current regulatory requirements, regulatory expectations and industry standards. In the event gaps or shortcomings are identified, an action plan should be implemented to address these findings in an expedited manner.

In the long run, the Department of the Treasury estimates that the new rule will actually cut costs in the way of reducing illicit activity. However, in the interim, financial institutions will still have to face the current challenges of adaptation.

GLOBAL RADAR
THE SOLUTION

Global RADAR is already up to the new standards set by FinCEN; in fact, we were up to the new standards well before the Final Rule was even announced. Global RADAR makes it easy to onboard new clients, manage existing client portfolios, complete investigations, produce management reports, and take corrective measures. Comprehensive reports allow you to comply, assessing the effectiveness of your compliance policies so you can quickly resolve any issues.

Global RADAR's sophisticated, automated risk rating process allows you to quickly identify high risk clients. We make it easier to effectively implement and manage the requirements by eliminating the time-consuming and costly efforts institutions would otherwise face.

Our system allows for easy tracking of ownership so that you can identify beneficial owners in accordance with the FinCEN Final Rule. Global RADAR also saves your institution time and money that would be wasted on other solutions featuring slow and costly implementation. Instead of facing all the challenges in updating and restructuring to meet the new standards, why not let our software do the heavy lifting? Global RADAR already has you covered.

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