

FinCEN's Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions

July 29, 2016

On July 19, 2016, the Financial Crimes Enforcement Network (“**FinCEN**”) issued twenty-six Frequently Asked Questions¹ (the “**FAQs**”) pertaining to the agency’s Customer Due Diligence rule (“**CDD Rule**”), published on May 11, 2016.² FinCEN issued the CDD Rule under the Bank Secrecy Act (“**BSA**”), clarifying and enhancing customer due diligence (“**CDD**”) requirements for financial institutions, and adding a new requirement for covered financial institutions to identify and verify the identity of the “beneficial owners” of certain of their legal entity customers.³ FinCEN released the FAQs to assist covered financial institutions in understanding the scope of their CDD requirements. By and large, the FAQs rearticulate the CDD Rule’s requirements for collecting beneficial ownership information with respect to legal entity customers. The FAQs also clarify FinCEN’s expectations regarding: (1) the CDD Rule’s impact on covered financial institutions’ broader anti-money laundering (“**AML**”) programs; (2) the information that covered financial institutions should collect under the CDD Rule, and how they should collect it; and (3) the interaction between covered financial institutions’ obligations under the CDD Rule and their obligations under existing AML rules and requirements. The CDD Rule became effective on July 11, 2016, and covered financial institutions must comply by May 11, 2018.

The CDD Rule’s Impact on Covered Financial Institutions’ AML Programs

The FAQs confirm that the CDD Rule adds a fifth requirement to covered financial institutions’ AML programs, requiring them to “implement and maintain appropriate risk-based procedures for conducting ongoing [CDD]” (FAQ 5). As a result, once the CDD Rule becomes applicable, the minimum AML program requirements for covered financial institutions will be:

- a system of internal controls;
- independent testing;
- designation of a compliance officer or individual(s) responsible for day-to-day compliance;
- training for appropriate personnel; and
- “appropriate risk-based procedures for conducting ongoing CDD to understand the nature and purpose of customer relationships and to conduct ongoing monitoring to identify and report suspicious transactions, and, on a risk basis, to maintain and update customer information.”

The FAQs clarify that the CDD Rule requires covered financial institutions to establish and maintain written procedures that are “reasonably designed” to identify and verify legal entity customers’ beneficial owners (FAQ 4). These procedures should enable covered financial institutions to: (1) identify the

¹ FinCEN, Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions, (July 19, 2016), [http://www.fincen.gov/statutes_regs/guidance/pdf/FAQs_for_CDD_Final_Rule_\(7_15_16\).pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/FAQs_for_CDD_Final_Rule_(7_15_16).pdf).

² Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29,398, 29,451 (May 11, 2016) (codified at 31 C.F.R. pts. 1010, 1020, 1023, 1024, 1026), <http://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf>.

³ For more information about the rule and what covered financial institutions must do to comply, see Davis Polk, [FinCEN’s Final Rule to Enhance Customer Due Diligence Requirements for Financial Institutions](#) (May 31, 2016).

beneficial owners of a legal entity customer when a new account is opened, unless the customer is otherwise excluded or the account is exempted,⁴ and (2) verify the identity of those beneficial owners to the extent reasonable and practicable. FAQ 7 clarifies that covered financial institutions are required to include the procedures for identifying and verifying the identity of legal entity customers' beneficial owners in their AML compliance program.

Putting the CDD Rule into Practice

FinCEN explains that the CDD Rule defines "beneficial owner" as each of the following: *each* individual, if any, who, directly or indirectly, owns 25% or more of the equity interests of a legal entity customer (the "ownership prong"), and a *single* individual with significant responsibility to control, manage, or direct a legal entity customer (the "control prong") (FAQ 9). Under the CDD Rule, therefore, a legal entity will have a total of between one and five beneficial owners — one person under the control prong *and* zero to four persons under the ownership prong.

FinCEN provides some clarification about the CDD Rule's illustrative, but not exclusive, list of positions that it considers as having significant responsibility to control, manage, or direct a legal entity customer in satisfaction of the control prong.⁵ FAQ 13 explains that FinCEN's expectation is that the identified control person should be a "high-level official" in the legal entity who is "responsible for how the organization is run, and who will have access to a range of day-to-day operations of the company."

The FAQs specify what information financial institutions should collect and how they should collect it. For each person deemed a beneficial owner under the ownership prong and for one person deemed a beneficial owner under the control prong, covered financial institutions must collect the following information: (1) name; (2) date of birth; (3) address; and (4) social security number or other government identification number (FAQ 11). In order to obtain this information, covered financial institutions may use either the Certification Form provided in Appendix A of the CDD Rule or their own forms (FAQ 19).

FAQs 1 and 12 emphasize that beneficial owners cannot be nominees or straw men, but FinCEN also reiterates that the onus is on the legal entity customer to identify its ultimate beneficial owners and not on the financial institution. The CDD Rule does not require financial institutions to obtain the required beneficial owner information from the beneficial owners themselves. Rather, the rule requires that financial institutions obtain the information from the individual opening a new account⁶ on behalf of the legal entity customer (FAQ 10).⁷ Covered financial institutions may rely on the information provided to them by the legal entity customer, unless they have reason to question the information's accuracy (FAQ 12).

FAQ 17 lists the four categories of accounts for which covered financial institutions are not required to collect beneficial ownership information, as well as the two circumstances under which those exemptions do not apply. FinCEN also lists which types of entities are excluded from the definition of legal entity customers, as specified in the CDD Rule (FAQ 21). In addition, in FAQ 22, FinCEN confirms that most trusts are not included in the definition of legal entity customer; only statutory trusts created by filing with

⁴ FAQ 16 specifies that the rule does not cover existing accounts opened before the applicability date.

⁵ The CDD Rule and FAQs 9 and 13 list chief executive officer, chief financial officer, chief operating officer, managing member, general partner, president, vice president, or treasurer as examples of the types of positions that may satisfy the control prong.

⁶ The FAQs specify that the definition of the term "account" under the CDD Rule is the same as that under the customer identification program ("CIP") rules for banks, brokers or dealers in securities, mutual funds, and futures commission merchants and introducing brokers in commodities (FAQ 14).

⁷ The individual opening the account on behalf of the legal customer may or may not be a beneficial owner himself or herself.

a Secretary of State or similar office are included. However, FinCEN notes that the CDD Rule does not supersede existing obligations and practices regarding trusts generally.

The CDD Rule's Interaction with Other AML Obligations

The FAQs also address the CDD Rule's interaction with CIP requirements, Office of Foreign Assets Control (“OFAC”) regulations, and obligations under Section 314(a) of the USA PATRIOT Act.

Under the CDD Rule, a covered financial institution's CDD procedures need not be identical to its CIP procedures (FAQ 6). Instead, to meet the CDD Rule's minimum requirements, the CDD procedures need only contain the same elements as required for verifying the identity of customers under the applicable CIP rule. In the case of documentary verification, for example, the CDD Rule permits covered financial institutions to use photocopies or other reproductions of qualifying identification documents.

FinCEN also makes explicit its expectation that beneficial ownership information collected by a covered financial institution be used for OFAC compliance purposes. FinCEN explains, “Covered financial institutions should use beneficial ownership information as they use other information they gather regarding customers (e.g., through compliance with the CIP requirements), including for compliance with OFAC-administered sanctions” (FAQ 23).

Finally, FAQ 24 clarifies that FinCEN does not expect that the CDD Rule will add obligations for covered financial institutions under Section 314(a). Because the regulations implementing Section 314(a) do not require financial institutions to report beneficial ownership information associated with an account or transaction matching a named subject in a 314(a) request, the collection of such information under the CDD rule will have no impact on a financial institution's 314(a) obligations.

Conclusion

Covered financial institutions have until May 11, 2018 to come into compliance with the CDD Rule. FinCEN states that it “intends to issue additional FAQs or guidance as appropriate,” so covered financial institutions may receive additional guidance before the date by which they are required to comply.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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