

Final Rule on Customer Due Diligence Requirements for Financial Institutions: The Basics



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Enfield, Feb 18, 2019 (IssueWire.com) - The aim of this article is to give you an insight into the Final Rule that was published by the Financial Crimes Enforcement Network (FinCEN) on May 11, 2016, for financial institutions.

As a US tax adviser and consultant, **Matthew Ledvina** wants to ensure that every citizen of United States should be aware of the fact that now it is prominent to provide the beneficial ownership information for financial institutions. This is because, the US government wants to protect terrorist financing as well as money laundering, and so they are modifying their laws to lock various ambiguities.

What is the Final Rule?

The Final Rule is a clear Customer Due Diligence (CDD) framework for all covered financial institutions (financial institutions subject to a CIP requirement, such as the banks, broker-dealers in security, futures commission merchants and mutual funds). It is targeted at developing a more balanced playing field across and within the financial sectors and to reduce the irregularities in CDD practices among financial institutions.

Furthermore, the four important elements of CDD necessary for the Anti-Money Laundering (AML) of the various Covered Financial Institutions are fully described by the Final Rule. They include:

- Identifying and verifying the identity of customers;
- Identifying and verifying the identity of beneficial owners of legal entity customers, subject to certain exceptions;
- Understanding the nature and purpose of customer relationships to develop a customer risk

profile;

- Ongoing monitoring for reporting suspicious transactions and, on a risk basis, maintaining and updating customer information.

The first element has already been covered by the existing Customer Identification Program (CIP) rules. Consequently, our focus in this article will be the second element (which is a new requirement) as well as the third and fourth elements, which are already indirectly implied in the suspicious activity reporting requirements, however, they have now been specifically included as the “fifth pillar” of an effective AML program.

What is the Purpose of the Final Rule?

The reason in which the CDD regime was clarified and strengthened as explained by the FinCEN is as follows:

- To assist financial investigations by law enforcement.
- To enhance the ability to identify the assets as well as accounts of criminals.
- To improve a financial institution’s ability to assess and mitigate risk, and adhere to existing requirements.
- To ensure tax compliance (including compliance with the Foreign Tax Compliance Act) by facilitating related reporting and investigations.
- To ensure consistency in CDD expectations across and within financial sectors.

SECOND ELEMENT: Beneficial Owner Requirements for Legal Entity Customers

There are some written guidelines that are specifically designed to reveal and verify the identities of beneficial owners of legal entity customers when a new account is opened and subject to certain exceptions. All covered financial institutions starting on the applicability date must implement these guidelines. They are:

Beneficial Owner

The Final Rule defined this in two prongs:

- **The Ownership Prong:** Here, a beneficial owner is described as each individual (if any) who, either directly or indirectly, possesses 25% or more of the equity interest (this applies to a variety of different legal structures and ownership situations) of a legal entity customer. This prong requires the identification of only four individual, however, if any individual does not meet the 25% requirement, then there is no need for identification.
- **The Control Prong:** Here, a beneficial owner is a single individual who is responsible for the control and management of a legal entity customer.

Legal Entity Customer

A “legal entity customer” is defined by the Final Rule as a corporation, limited liability company or any other entity created through the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entities formed under the laws of foreign jurisdictions that opens an account. In other words, legal entity customers do not include sole proprietorship, unincorporated associations, trusts (except statutory trusts created under a state filing) or natural individuals opening accounts in their own name.

Control Prong Only

There are some legal entity customers that are subjected to the control prong of the beneficial ownership requirement, either due to the fact that the ownership interests tend to fluctuate or because they do not exist. They include any legal entity established as a non-profit corporation or similar entity as well as a pooled investment vehicle operated or advised by a financial institution that is not an Excluded Legal Entity (such as hedge funds and private equity funds).

New Account

According to the CIP rules, this represents each account opened at a Covered Financial Institution by a legal entity customer on or after the date of applicability. The beneficial ownership requirements apply to these accounts. However, there are some accounts that are exempted from the requirements, for instance, an account opened for a legal entity customer at the point-of-sale to provide credit products.

Identification and Verification Requirements

According to the Final Rule, a covered financial institution's procedures should permit it to:

- Identify the beneficial owners of each legal entity customer (unless the entity is excluded or account exempted) at the time the new account is opened.
- Verify the identity of such beneficial owners according to the CIP rules and procedures within a reasonable time after the opening of the account.

THE FIFTH PILLAR: Amendment to AML Program Requirements

The Final Rule revises FinCEN's existing program requirements for covered financial institutions by incorporating the traditional first four pillars and including a "fifth pillar". This pillar is targeted at covering the third and fourth elements of CDD. It requires appropriate risk-based procedures for conducting ongoing CDD which only includes, but not limited to the third and fourth CDD elements.

THIRD ELEMENT: Understanding the Nature and Purpose of Customer Relationships

This element requires all covered financial institutions to come up with a customer risk profile by understanding nature as well as the purpose of customer relationships. FinCEN is of the opinion that this third element (alongside the types of transactions the customer-in-question normally engages in) is considered necessary for covered financial institutions to identify and report suspicious activity.

FOURTH ELEMENT: Ongoing Monitoring

This CDD element requires all covered financial institutions to identify and report suspicious activities and also to maintain and update customer information (on a risk basis) through ongoing monitoring. Consequently, covered financial institutions are required to possess sufficient control and monitoring tools.

About Matthew Ledvina

[Matthew Ledvina](#) is an experienced tax adviser and is the co-founder of Aerium Capital and director for a Fintech company in London. He is extremely passionate about his work, and his objective is to provide with everyone a secure lending platform. He is truly a genius in tax adviser.

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