

The Complete Compliance and Ethics Manual 2023 Customer Due Diligence and Beneficial Ownership

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Introduction

Identifying and verifying financial institution customers' beneficial ownership has long been considered a component of anti-money laundering (AML) programs. A beneficial owner, broadly, is someone who receives the benefits of ownership in certain forms of property, even though that person's name is not on the property's title. However, international guidance and regulatory expectations of when and to what extent such identification/verification is necessary has varied. In 2016, US regulators, through the voice of the Financial Crimes Enforcement Network (FinCEN), took a definitive position on the importance of beneficial ownership through the issuance of the Customer Due Diligence Requirements for Financial Institutions final rule.^[2] FinCEN is a bureau in the U.S. Department of the Treasury that is responsible for implementing US AML laws. The following sections of this article explain the final rule and the concept of beneficial ownership as viewed through the US regulatory lens.

The Final Rule—Setting the Stage

Complex legal entity structures have often been used by individuals to disguise illicit financial activity. Unscrupulous individuals have used the anonymity provided by legal entity structures as a shield to engage in a variety of crimes like money laundering, fraud, corruption, terrorist financing, and evasion of sanctions regulations. To pierce this potential shield, US regulators have formalized the requirement that covered financial institutions obtain and verify the beneficial ownership information for legal entity customers.

On May 11, 2016, FinCEN released the final rule. The final rule became effective on July 11, 2016, and covered financial institutions had until May 11, 2018, to become compliant. This two-year implementation period was a direct response to heavy commentary from the financial services industry through a collaborative process with FinCEN.^[3]

The final rule amended the Bank Secrecy Act (BSA) regulations to clarify that customer due diligence (CDD) is a required regulatory element of an AML program and that CDD must include “identifying and verifying the identity of beneficial owners of legal entity customers.”^[4]

As a result of financial institution feedback, on September 7, 2018, FinCEN granted exceptive relief to the beneficial ownership requirement for legal entity customers who opened a new account as a result of any of the following:

- “A rollover of a certificate of deposit...;
- “A renewal, modification, or extension of a loan...that does not require underwriting review and approval;
- “A renewal, modification, or extension of a commercial line of credit or credit card account...that does not require underwriting review and approval; and

- “A renewal of a safe deposit box rental.”^[5]

This exception relief applies only to the rollover, renewal, modification, or extension of any of the above types of accounts on or after the May 11, 2018, implementation deadline of the final rule and does not apply to the initial opening of such accounts. FinCEN’s granting of this exceptive relief followed its initial May 16, 2018, grant of temporary relief after financial institutions noted that a large number of renewals and rollovers happened automatically and, in the ordinary course, the financial institutions would not need to reverify beneficial ownership information.

FinCEN stated that the final rule would enhance financial transparency, protect the financial system from illicit use, and advance the goals of the BSA by:

- enhancing the availability of beneficial ownership information to law enforcement and the federal functional regulators in investigations and regulatory examinations;
- increasing the ability of financial institutions and government agencies to identify the assets of terrorist organizations, money launderers, drug kingpins, proliferators of weapons of mass destruction, and other national security threats, and strengthening compliance with economic sanctions programs;
- helping financial institutions to assess and mitigate BSA and AML risk and comply with existing legal requirements;
- facilitating tax reporting, investigations, compliance and US commitments to foreign governments with respect to the Foreign Account Tax Compliance Act;
- promoting consistency in the implementation and enforcement of the regulators’ expectations across financial sectors; and
- advancing the Treasury Department’s broad strategy to enhance financial transparency of legal entities.^[6]

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