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Newsletter for Audit, Compliance, Security, IT, Credit Analyst, Lending, and BSA Officers

Spring 2018

CERTIFICATION NEWS

REGULATORY

FinCEN's Customer Due Diligence Rule: Are You Ready for May 11, 2018?

By Daniel P. Stipano, Ellen M. Warwick, Benjamin W. Hutten and Brendan M. Clegg

Regulators gave financial institutions two years to prepare for new requirements that will fundamentally change the procedures they use to gather information about their customers. In preparation for the May 11 implementation of the Customer Due Diligence (CDD) Rule, many covered financial institutions have upgraded their technology, systems, procedures, and training to accommodate the new requirements.

Their efforts, however, have not guaranteed peace of mind. Prudential regulators have already signaled their intention to begin examining banks for compliance shortly after the effective date, but neither they nor FinCEN have issued any examination procedures on the rule itself. This may loom as less of a concern to banks with significant BSA systems and infrastructures which have anticipated the new requirements. Other banks, however, may feel less certain of their preparations.

Given the policy goals of the new rule, regulators will have high expectations for institutions of all sizes. Those assessing whether they are well-positioned to withstand regulatory scrutiny should focus on compliance with the requirements of the rule as described below.

The Rule

By far the most significant aspect of the CDD Rule is the requirement that banks and other covered institutions identify, and verify the identities, of the beneficial owners of legal entity customers. The CDD Rule defines a "beneficial owner" in two ways:

- Ownership prong: Anyone who owns 25 percent or more of the legal entity.
- Control prong: A person with significant responsibility to control, manage, or direct a legal entity customer.

Notwithstanding the definition, the CDD rule is risk based, so regulators may expect banks to collect beneficial ownership information on individuals with less than a 25 percent ownership interest, particularly where higher-risk customers are involved. Once all beneficial owners have been identified, the CDD Rule requires verification of their identities through documentary or nondocumentary methods.

In addition to the beneficial ownership requirements, the CDD Rule adds a "Fifth Pillar" to the Bank Secrecy Act program requirements. Under the "Fifth Pillar," banks will be required to have risk-based procedures that enable them to: understand the nature and purpose of customer relationships for the purpose of developing a customer risk profile; conduct ongoing monitoring to identify and report suspicious transactions; and, on a

*See **FinCEN's CCD Rule**, page 2*

2018 CERTIFICATION CALENDAR

Audit Institute (Week 1)
- Sept. 10-14; Minneapolis, Minnesota

Audit Institute (Week 2)
- Sept. 17-21; Minneapolis, Minnesota

Annual Current Issues/ Certification Conference
- Sept. 24-27; Minneapolis, Minnesota
- Oct. 22-25; Phoenix, Arizona

Bank Security Institute
- Sept. 9-12; Minneapolis, Minnesota

BSA/AML Institute
- May 15-17; Minneapolis, Minnesota
- July 30-Aug. 1; Kansas City, Missouri
- Nov. 14-16; Dallas, Texas

Compliance Institute
- June 10-15; Minneapolis, Minnesota
- Sept. 30-Oct. 5; Nashville, Tennessee

Commercial Lending Institute
- Aug. 19-24; Minneapolis, Minnesota

Consumer Lending Institute
- Sept. 16-19; Minneapolis, Minnesota

Credit Analyst Institute
- Nov. 4-7; Dallas, Texas

IT Institute
- Aug. 6-10; Minneapolis, Minnesota

Attending the Annual Current Issues/ Certification Conference? Please submit topics you'd like to see covered to: *communitybankeruniversity@icba.org.*

FinCEN's **CCD Rule** *Continued from page 1*

risk basis, maintain and update customer information, including beneficial ownership information.

Implementation of the Rule's Requirements

The goal of examiners will be to determine how completely your institution has implemented and operationalized the CDD Rule's requirements. Therefore, the following topics could be covered within the scope of your institution's examination:

- The CDD Rule adds customer due diligence as a required "Fifth Pillar" of a Bank Secrecy Act/Anti-Money Laundering compliance program. Is your BSA/AML program updated to explicitly address customer due diligence as a Fifth Pillar?
  - Do your procedures specifically address understanding the nature and purpose of the relationship and creating a customer risk profile?
  - Do your procedures specifically address updating customer information (including beneficial ownership) on a risk basis?
- Has your institution reviewed and, as necessary, updated its overall BSA/AML risk assessment to address the beneficial ownership and customer due diligence requirements of the CDD Rule?
- The purpose of the basic beneficial ownership requirement is to establish and maintain written procedures to identify and verify the beneficial owners of legal entity customers. Has your institution implemented these procedures?
  - Has your institution determined which business lines will be impacted by the rule, and updated customer onboarding and approval procedures for those business lines?
  - Do these procedures include updates to the customer identification program (CIP) to incorporate beneficial owners of legal entity customers?
  - Do these updated procedures incorporate FinCEN's certification form or a proprietary form collecting the same information?
  - Are recordkeeping procedures updated to maintain records of the identities of beneficial owners and the document/method relied on for verification of the beneficial owner's identity?
- Has your institution identified the common types of business entities it services and determined whether such businesses meet the definition of "legal entity customer," or qualify for one of the numbers exemptions?
- Has your institution updated its Office of Foreign Assets Control (OFAC) procedures to incorporate screening of beneficial owners and, as appropriate, aggregation of sanctions-targeted ownership interests for purposes of OFAC's 50 Percent Rule?
- Has your institution addressed how it will use beneficial ownership information for purposes of aggregating cash transactions for currency transaction reporting purposes?
- If your institution will rely on another institution for obtaining and/or verifying beneficial ownership information, has it made a written determination that such reliance is reasonable, verified that the other institution is subject to BSA/AML program requirement, and entered into a contract with the other institution certifying that it has complied with its BSA/AML program?
- If your institution will rely on a vendor for verification of the identity of beneficial owners, has it established controls to oversee the vendor's performance and validate the vendor's verification processes?
- Has your institution implemented changes to its IT systems to incorporate the above changes?
- Have all personnel/functions impacted by the CDD Rule or

Did You Know?

On April 9, 2018 the Federal Agencies amended the Real Estate Appraisals Rule. The Appraisal Rule increases the current appraisal threshold for commercial real estate (CRE) transactions from $250,000 to $500,000. The final rule defines commercial real estate transaction as a real estate-related financial transaction that is not secured by a single 1-to-4 family residential property. For commercial real estate transactions exempted from the appraisal requirement as a result of the revised threshold, regulated institutions must obtain an evaluation of the real property collateral that is consistent with safe and sound banking practices. To read the final rule visit: *https://www.fdic.gov/news/board/2018/2018-03-20-notice-sum-c-fr.pdf*.

FinCEN's, continued from page 2

responsible for implementing its requirements been identified and appropriately trained?
- Has your independent testing, internal controls, and audit function been updated to include verification that the above changes have been implemented and are meeting the requirements of the CDD Rule?

Gray Areas and Decision Points

The CDD Rule's requirements have a number of gray areas that must be addressed during implementation. In the absence of meaningful guidance, institutions should document their rationale for any major decisions, especially where application of the rule to their business is unclear. A non-exhaustive list of major decision points, some of which have already been the subject of bank examiner inquiries, would include:

- Will legal entity customer risk profiles incorporate information about beneficial owners? When?
- Will your institution conduct additional diligence, such as negative media searches, on beneficial owners? If so, when?
- Will your institution collect information on individuals with less than 25 percent equity interests in a legal entity customer? If so, under what circumstances?
- What events will trigger an update to customer information, including beneficial ownership information, for existing customers?
- There are over 12 exclusions from the definition of "legal entity customer," a number of which can be challenging to apply. Where the application of these exclusions is unclear to certain categories of customers, has your institution made a reasoned and documented decision whether to obtain and verify beneficial ownership information?
  - This exercise will be easier to conduct without the time pressures of receiving a request to open a new account or a question from an examiner.
- Will your organization set parameters or expectations regarding the level of responsibility or authority held by the person identified as the control person for purposes of the beneficial ownership requirements?
- Are there any circumstances under which your institution will not rely on beneficial ownership information provided by the customer? If so, what are they?
- Will your institution obtain and verify beneficial ownership information every time a new account is opened for a legal entity customer, even if the intervening time period is very small?
- What will your institution do in the event that it is unable to verify the identity of beneficial owners?
- In cases where numerous legal entity customers share the same beneficial owner, or where an individual holding an account is identified as a beneficial owner of a legal entity customer, will your institution review these accounts collectively for purposes of account monitoring or investigating potentially suspicious activity? If so, in what circumstances?

Going Forward

A good place to start with respect to compliance with the CDD Rule is to ensure that the requirements of the rule have been incorporated into your institution's policies and procedures. The federal banking agencies will expect banks' policies, procedures, and processes to comply with the rule's requirements following the CDD Rule's applicability date. Similar to other examination procedures in the area of BSA/AML, institutions might anticipate that examiners would focus, at least initially, on high-risk business lines or customers. Institutions can address the current lack of clarity in supervisory expectations by staying connected to their peers, the industry, and their counselors for updates and benchmarking. They may also conduct readiness reviews to identify weaknesses before their examiners do. Finally, institutions would benefit from an open dialogue with examiners regarding the CDD Rule's gray areas and any impediments to full compliance as of the applicability date to avoid surprises during examinations.

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Remember!

Important Compliance Dates

Effective Date	Regulatory Change
May 11, 2018	Effective date for Bank Secrecy Act Customer Due Diligence and Beneficial Ownership requirements. To learn more, visit *https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf*
July 1, 2018	Effective date for amendments to Regulation CC regarding check collection and return provisions. To read the final rule, visit *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170531a1.pdf*
Oct. 1, 2018	Mandatory effective date for the 2017 TILA-RESPA final rule which provides clarification and changes to the existing TILA-RESPA rule which was effective Oct. 3, 2015. Note: Your bank may have already implemented some of the clarifications and changes that were allowed immediately upon publishing the final rule on July 7, 2017, but Oct. 1, 2018 requires all covered institutions to comply. To learn more, visit *https://www.federalregister.gov/documents/2017/08/11/2017-15764/amendments-to-federal-mortgage-disclosure-requirements-under-the-truth-in-lending-act-regulation-z*

Have additional questions? Community Banker University staff are happy to assist you. Contact us at 800-422-7285.