



GLOBAL INVESTIGATIONS AND COMPLIANCE

FOURTH ANTI-MONEY LAUNDERING DIRECTIVE AND FinCEN CDD RULE: HOW FINANCIAL INSTITUTIONS CAN ALIGN WITH REGULATORY REQUIREMENTS

EXECUTIVE SUMMARY

The continuing global regulatory focus on anti-money laundering (AML) and countering the financing of terrorism (CFT) has led governments to strengthen regulatory regimes around the world. In the European Union (EU), the Fourth Anti-Money Laundering Directive 2015/849/EU (4th AMLD) — the UK implementation of which came into effect in June 2017 — has brought about a number of changes to the way firms and regulators deal with AML/CFT issues. In the United States, the Financial Crimes Enforcement Network's (FinCEN's) new Customer Due Diligence Requirements for Financial Institutions Rule (CDD Rule) effective July 11, 2016, became applicable on May 11, 2018. The CDD Rule will require firms to look again at their approach to customer due diligence and has the potential to lead to increased regulatory scrutiny in this area.

In this paper, Navigant Consulting, Inc. compares the key parts of the 4th AMLD and the CDD Rule; discusses their impact on financial institutions subject to both sets of requirements; and offers recommendations to align with regulatory expectations.

BACKGROUND

EU 4th AMLD

All EU member states were required to implement the 4th AMLD (which replaced the previous Third Directive) by June 26, 2017. The purpose of the Directive is to remove ambiguities in the previous legislation, and improve consistency of AML and CFT rules across all EU member states. The primary areas of change relate to:

1. Beneficial ownership
2. Customer due diligence
3. The risk-based approach
4. Ongoing monitoring
5. Politically exposed persons
6. Third-party equivalence

CONTACTS

ALMA ANGOTTI

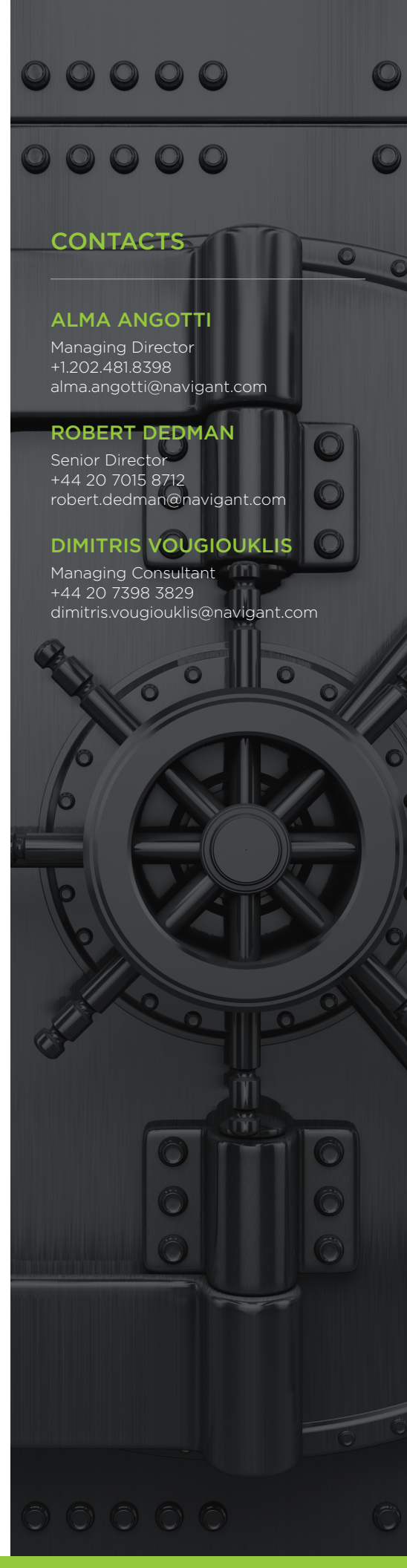
Managing Director
+1.202.481.8398
alma.angotti@navigant.com

ROBERT DEDMAN

Senior Director
+44 20 7015 8712
robert.dedman@navigant.com

DIMITRIS VOUGIOUKLIS

Managing Consultant
+44 20 7398 3829
dimitris.vougiouklis@navigant.com





FinCEN CDD Rule

On May 11, 2016, FinCEN issued its long-awaited final rule on customer due diligence and beneficial ownership information requirements. To allow financial institutions sufficient time to incorporate any necessary changes, the compliance date was set for May 11, 2018, two years from the issuance of the final rule.

FinCEN issued the CDD Rule to clarify and strengthen CDD requirements for covered financial institutions.¹ The CDD Rule has two parts. First, the rule requires the financial institution to collect beneficial ownership and control person information on its customers, subject to some exclusions and exemptions. Second, the CDD Rule amended the AML program requirements, adding to the existing four pillars a new fifth pillar requiring financial institutions to design risk-based procedures for conducting ongoing customer due diligence. The procedures must include developing a customer risk profile, and using that profile to conduct ongoing monitoring to update and maintain customer information, as well as identify and report suspicious activity. While a significant part of the new rule is framed by FinCEN as a clarification of existing regulatory expectations rather than new requirements, the key changes relate to:

1. Beneficial ownership
2. Creating and maintaining a customer risk profile

Comparison of 4th AMLD and FinCEN CDD Rule

Those financial institutions subject to both sets of requirements will need to consider the extent to which the 4th AMLD and FinCEN CDD Rule requirements are similar or impose different standards. The table below summarizes, side by side, the key parts of the two regulatory frameworks.

1. On Nov. 21, 2017, FINRA issued *Regulatory Notice 17-40: FinCEN's Customer Due Diligence Requirements for Financial Institutions and FINRA Rule 3310*.

COMPARISON	4 th AMLD	FinCEN CDD RULE
Implementation or Applicability Date	<ul style="list-style-type: none"> June 26, 2017 	<ul style="list-style-type: none"> May 11, 2018
Coverage	<ul style="list-style-type: none"> Applies to obliged entities, namely financial institutions, credit institutions, auditors, external accountants, tax advisors, notaries and independent legal professionals, trusts, estate agents, and providers of gambling services (not just casinos) 	<ul style="list-style-type: none"> Applies to covered institutions, which include banks, branches, and agencies of foreign banks in the United States; broker-dealers; mutual funds; futures commission merchants; and introducing brokers in commodities
Beneficial Ownership	<ul style="list-style-type: none"> Imposes new requirements to identify the beneficial owner and take reasonable measures to verify that person's identity Extends identification and verification of beneficial owners to legal entities that own other legal entities Requires identification and verification of customers' identities on the basis of documents, data, or information obtained from a reliable and independent source Establishes a shareholding or ownership of 25% or more assumes beneficial ownership 	<ul style="list-style-type: none"> Imposes new requirement to identify and verify the identity of beneficial owners and a control person of legal entity customers at account opening² Requires certification to be collected from the legal entity customer at account opening, and provides a model form for doing so³ Allows financial institutions to rely on the beneficial ownership information supplied by the customer, provided that financial institutions have no knowledge of facts that would reasonably call into question the reliability of the information Establishes a minimum threshold for collection of beneficial ownership at 25%, whether directly or indirectly held
CDD	<ul style="list-style-type: none"> New requirement for obliged entities to determine the level of risk prior to applying simplified CDD Requirement to explain why simplified CDD is applied; obliged entities are now required to undertake enhanced due diligence (EDD) when dealing with companies in designated high-risk countries, to both manage and mitigate risks — the factors of higher-risk situations that require EDD are: <ul style="list-style-type: none"> Customer risk factors. Product, service, transaction, or delivery channel risk factors Geographical risk factors 	<ul style="list-style-type: none"> Requirement to have an AML program that includes risk-based procedures for conducting ongoing due diligence to include: <ul style="list-style-type: none"> Understanding the nature and purpose of customer relationships to build a customer risk profile Conducting ongoing monitoring for reporting suspicious transactions and, on a risk basis, maintaining and updating customer information

2. The definition of account in the CDD Rule is the same as used in the CIP rule. On April 3, 2018, FinCEN issued Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions, in which FinCEN identified that each time a loan is renewed or a certificate of deposit is rolled over, the bank establishes another formal banking relationship and a new account is established, noting that these products are "not generally treated as new accounts by the industry." See "Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act, FAQs: Final CIP Rule," p. 8 (April 28, 2005) and FIN-2018-G001 titled "Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions."

3. On May 16, 2018 FinCEN released an Administrative ruling providing a 90-day limited exceptive relief (retroactive to May 11, 2018, and expiring on Aug. 9, 2018) with respect to certain products and services that automatically roll over or renew (e.g., CD rollovers, loan renewals). See FIN-2018-R002 titled "Beneficial Ownership Requirements for Legal Entity Customers of Certain Financial Products and Services with Automatic Rollovers or Renewals."

COMPARISON	4 th AMLD	FinCEN CDD RULE
Record Retention	<ul style="list-style-type: none"> • Five years maximum retention period for CDD documentation after the business relationship has ended, which can be extended to 10 years if required by local legislation 	<ul style="list-style-type: none"> • Must have procedures for making and maintaining a record of identification and verification for five years after the record is made or the account is closed
Risk-Based Approach	<ul style="list-style-type: none"> • Increases the emphasis on firms following a risk-based approach • Considers risk factors such as customer; geography; product; and channel to identify, assess, and mitigate AML/CTF risk 	<ul style="list-style-type: none"> • Covered financial institutions are to take a risk-based approach to updating customer information, including beneficial ownership information that was collected at account opening; specifically, FinCEN expects that updates to customer information will be event driven (i.e., in response to a trigger event)
Ongoing Monitoring	<ul style="list-style-type: none"> • New requirement to be more prescriptive with regards to ongoing monitoring of customers • Outlines factors for conducting customer risk assessment and how these risk assessments are kept up-to-date • In addition, be able to share rationale behind the risk rating applied to each customer 	<ul style="list-style-type: none"> • Codifies the existing requirement to conduct ongoing monitoring to identify and report suspicious activity • During normal monitoring for suspicious activity, if the firm detects information relevant to assessing the customer's risk profile, it must update the customer information, including the beneficial ownership information



IMPLICATIONS FOR FINANCIAL INSTITUTIONS

There are a number of implications for financial institutions subject to both regulatory regimes, including:

An increase in de-risking.

Under the 4th AMLD, there is potential to increase de-risking practices of existing customers that fall outside the risk appetite of the financial institution based on beneficial ownership information held in public registers. The CDD Rule may also lead some financial institutions to terminate relationships with certain customers whose information is not easily obtainable, or from which the financial institution cannot obtain the required certification of beneficial ownership, regardless of whether the customer falls within the financial institution's risk appetite. Financial institutions subject to both regimes will need to clearly articulate the processes for rejecting and exiting customers in their CDD procedures.

New processes and procedures for beneficial owners.

As a result of the 4th AMLD, obliged entities must have auditable processes and procedures that can identify and verify beneficial owners or those with ultimate control, and ensure that their information on beneficial ownership is accurate and up-to-date. As a result, firms must also review customer risk rating and transaction monitoring based on beneficial ownership information held in public registers.

The CDD Rule standardizes the approach for collecting beneficial ownership information on legal entity customers at account opening, and requires updating that information if, in the course of normal monitoring, the financial institution determines that information may have changed.⁴ With respect to products and services that automatically roll over or renew creating a new account such as CDs or loan renewals, financial institutions should use the 90-day period granted by FinCEN Administrative Ruling FIN-2018-R002 to review and update their existing processes in order to flag those accounts as requiring certification to be collected, and request at the time of certification that legal entity customers agree to notify the financial institution of any change in such information.⁵ In this way, they avoid being noncompliant with beneficial ownership requirements for legal entity customers after the 90-day limited exceptive relief expires on Aug. 9, 2018.⁶

The CDD Rule is prescriptive on which customers require collection of beneficial ownership information. For example, importantly for entities operating in both regimes, legal entities publicly traded on non-U.S. exchanges are not categorically excluded from the beneficial ownership requirements. Covered institutions should review controls to ensure that the beneficial ownership information collected is used, for example, to inform ongoing monitoring investigations, or to avoid opening or maintaining an account involving individuals or entities subject to Office of Foreign Asset Control-administered sanctions.

Updates to customer information using a risk-based approach.

The 4th AMLD requires obliged entities to consider various risk factors (e.g., ownership, location of customer) before applying simplified due diligence (SDD) and EDD. Current AML/CTF processes and procedures must be reviewed to identify updates required to SDD/EDD, and systems and controls assessed to ensure that firms can apply SDD/EDD. Covered institutions under the CDD Rule will need to review and identify the trigger events that will require the firm to update customer information in the risk profile, including instances in which a new certification of beneficial ownership and control person information must be obtained. In addition, financial institutions may need to review and update identification and verification processes and procedures, systems, and controls to ensure that the rationale for the risk score assigned to customers incorporates information known about the beneficial owners.

Updates to training programs to ensure consistent application of new regulatory requirements.

Covered institutions should also update training programs for first and second line of defense to ensure consistent understanding of beneficial ownership and CDD requirements under the 4th AMLD and the CDD Rule.

4. Financial Crimes Enforcement Network, Treasury, 31 CFR Parts 1010, 1020, 1024, and 1026, RIN 1506-AB25, *Customer Due Diligence Requirements for Financial Institutions*, Action: Final rules, available at <http://federalregister.gov/a/2016-10567> and on FDsys.gov.

5. FinCEN has stated that financial institutions can rely on such agreements as certification or confirmation from the legal entity customer so long as the loan or CD is outstanding. See Question 12: Collection of beneficial ownership information: Product or service renewals under FinCEN Guidance FAQs, (April 3, 2018).

6. See FIN-2018-R002 titled "Beneficial Ownership Requirements for Legal Entity Customers of Certain Financial Products and Services with Automatic Rollovers or Renewals."

About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage, and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the firm primarily serves clients in the healthcare, energy, and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at navigant.com.

How Navigant Can Help

Navigant's team of experts bring deep experience and significant expertise in both the U.S. and EU AML regimes to assist firms with changes and revisions to financial crime programs, and existing know-your-customer and CDD policies, procedures, and controls.

NAVIGANT'S RECOMMENDATIONS

The extent to which a financial institution operating on both sides of the Atlantic will be impacted by the two regulatory frameworks will to a large extent depend on the institution's size, inherent risks, and customer base. Financial institutions should consider:

Performing a holistic review of the demands of the 4th AMLD and the CDD Rule versus current practices to evaluate the extent of change required across the organization to comply with regulatory obligations.

Communicating the areas of similarity and difference between the 4th AMLD and the CDD Rule, and considering the extent to which to review policies and procedures to meet regulatory demands (including whether there is a need to work to the higher of the two standards).

Assessing systems and controls changes to ensure that updates required as a result of both regulatory frameworks are implemented in a coordinated manner and improve the organizations' operational efficiency.

Assessing the impact of updating customer information in one jurisdiction on the rules in other jurisdictions. For example, new information revealed as a result of a periodic refresh in Europe following the 4th AMLD may itself be a trigger event under the CDD Rule. Therefore, firms should consider whether they need new systems, controls, or processes to ensure compliance with both regulatory frameworks.