



GLOBAL INVESTIGATIONS AND COMPLIANCE

UPDATES REGARDING FINCEN'S NEW CDD RULE

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INTRODUCTION

Since the May 11, 2018, implementation date of the new Customer Due Diligence Requirements for Financial Institutions Rule (CDD Rule) a number of significant events have taken place, including a series of updates from the Financial Crimes Enforcement Network (FinCEN), public statements by FinCEN's new director to give covered financial institutions comfort that the agency understands the challenges with implementation, and the issuance of new guidance from the Federal Financial Institutions Examination Council (FFIEC). In March, in advance of the implementation date, the Ninth Circuit Court of Appeals ruled that the FFIEC manual is more than simply a guide that covered financial institutions should follow.

EXECUTIVE SUMMARY

As an initial matter, FinCEN appears to recognize the difficulty of implementing a new rule with such profound effects on the anti-money laundering (AML) operations of covered financial institutions, even with a two-year implementation period. For example, FinCEN has placed a 90-day "excepted relief" on a component of the CDD Rule and Director Kenneth A. Blanco has stated that FinCEN is not going to play a "gotcha game" as it oversees the industry's compliance with the new regulations.

Concurrent with the implementation date of the CDD Rule, the FFIEC issued new examination procedures on the CDD Rule in its *Bank Secrecy Act/Anti-Money Laundering Examination Manual (FFIEC Manual)*.² The *FFIEC Manual* is provided to assist bank examiners by creating examination procedures to test the effectiveness and sustainability of a covered financial institution's compliance with Bank Secrecy Act (BSA)/AML regulations. The *FFIEC Manual* also provides covered financial institutions with notice of how the regulators will examine their institutions, including now, examining for compliance with the new CDD Rule.

1. The authors wish to thank Joseph Frenkel and Patrick Haig for their assistance.

2. The *FFIEC Manual* is written collaboratively among the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, the National Credit Union Administration, the Office of the Comptroller of the Currency, state banking agencies, and the Financial Crimes Enforcement Network. See *California Pacific Bank v. FDIC*.



Importantly, the FFIEC’s procedures were issued subsequent to the March 12, 2018, ruling in *California Pacific Bank v. FDIC*. In that case, the Ninth Circuit Court of Appeals held, in part, that the *FFIEC Manual* “can put regulated banks on notice of expected conduct” because the “agency’s interpretation of its own regulations is controlling unless plainly erroneous or inconsistent with the regulation”³ or an alternative reading is compelled by the plain language of the regulation. In sum, according to the court, the guidelines set out in the *FFIEC Manual* for BSA/AML compliance, should be given deference by covered financial institutions.

The practical effect of *California Pacific Bank v. FDIC* is that the *FFIEC Manual* should no longer be considered a “guide”; rather, it should be considered an “authoritative resource.” To that end, covered financial institutions must ensure their internal controls and systems are in line with FFIEC guidelines, including the new guidance regarding compliance with the CDD Rule. Both the Securities and Exchange Commission and the Office of the Comptroller of the Currency, the latter of which is party to the FFIEC, have indicated that the CDD Rule will be a focus in 2018.⁴

Navigant Consulting, Inc. provides below a reference guide that sets out the significant changes, guidance, and speeches regarding the new CDD Rule since the implementation date on May 11, 2018.

Category: Regulatory Advisory

SOURCE	DATE ISSUED	TOPIC	SUMMARY
FinCEN	06/12/2018	FIN-2018-A003: Advisory on Human Rights Abuses Enabled by Corrupt Senior Foreign Political Figures and their Financial Facilitators	<p>FinCEN issued an advisory to highlight the connection between corrupt senior foreign political figures (or their facilitators) and human rights abuses.</p> <p>The advisory identifies a number of red flags to assist financial institutions in identifying methods used to move and hide proceeds of corruption that may directly or indirectly contribute to human rights abuses, and refers to the section of the <i>FFIEC Manual</i> that details supervisory expectations related to FinCEN rules and guidance regarding Financial Action Task Force Recommendation 12 on the risks associated with politically exposed persons (PEPs).</p> <p>The advisory further reiterates U.S. financial institutions’ risk-based due diligence obligations, and indicates that the agency expects that the new CDD Rule will facilitate identification of legal entities owned or controlled by PEPs.</p> <p>Link to source: https://www.fincen.gov/resources/advisories/fincen-advisory-fin-2018-a003 </p>

3. Reference to *Auer v. Robbins*, 519 U.S. 452 (1997) in *California Pacific Bank v. FDIC*.

4. See U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, *2018 National Exam Program Examination Priorities*, p. 10, and Office of the Comptroller of the Currency, *Fiscal Year 2018 Bank Supervision Operating Plan and Office of the Comptroller of the Currency Committee on Bank Supervision*, p.7.

Category: Public Testimony

SOURCE	DATE ISSUED	TOPIC	SUMMARY
House Financial Services Committee	05/16/2018	Terrorism and Illicit Finance Subcommittee Meeting - Implementation of FinCEN's Customer Due Diligence Rule	<p>FinCEN Director Kenneth A. Blanco testified in front of the House Financial Services Committee's Subcommittee on Terrorism and Illicit Finance.</p> <p>In his written testimony, Director Blanco acknowledges that while FinCEN expected covered institutions to be ready on the implementation date of the CDD Rule, and while FinCEN did hear from many in the industry that they were ready, FinCEN recognizes that more time is required to fine-tune the implementation of the new rule.</p> <p>The FinCEN director encouraged financial institutions to inform their examiners of issues early on and to share concerns with FinCEN.</p> <p>Link to source:</p> <p>https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403384</p>



Category: Regulatory Relief

SOURCE	DATE ISSUED	TOPIC	SUMMARY
FinCEN	5/16/2018	Beneficial Ownership Requirements for Legal Entity Customers of Certain Financial Products and Services with Automatic Rollovers or Renewals	<p>Under the Customer Identification Program Rule and subsequent regulatory guidance, when a loan is renewed, or a certificate of deposit is rolled over, the renewal or rollover constitutes a new account. The establishment of a new account would require covered financial institutions to identify and verify beneficial owners of a Legal Entity Customer as defined by, and in accordance with, the CDD Rule.</p> <p>Covered financial institutions have expressed concerns about their ability to comply with this requirement with respect to such accounts, as some covered financial institutions have automated processes to renew or roll over certain products and services and have not historically treated automatic rollovers or renewals as new accounts.</p> <p>FinCEN issued 90-day limited exceptive relief from the Beneficial Ownership requirement applicable to certain products and services that automatically renew or roll over, such as certificates of deposit or loan accounts, established before the applicability date of the CDD Rule. The relief granted is retroactive and applicable from May 11, 2018, up to and including August 9, 2018.</p> <p>Link to source: https://www.fincen.gov/sites/default/files/2018-05/FinCEN%20Ruling%20CD%20and%20Loan%20Rollover%20Relief_FINAL%20508-revised.pdf </p>
FinCEN	05/11/2018	Premium Finance Cash Refunds and Beneficial Ownership Requirements for Legal Entity Customers	<p>FinCEN issued a ruling granting relief to covered financial institutions with respect to Legal Entity Customers who open [insurance] premium financing products that allow for cash refunds. Covered institutions are not required to identify and verify the identity of beneficial owners of Legal Entity Customers who establish this type of account.</p> <p>After an analysis by FinCEN, exceptive relief has been granted due to the low AML risk associated with this type of premium financing product, where short-term financing of insurance premiums is provided by a lender who remits payment of a customer's insurance premium directly to an insurance carrier. There is no expiry date on this exceptive relief.</p> <p>Link to source: https://www.fincen.gov/sites/default/files/administrative_ruling/2018-05-11/FIN-2018-R001.pdf </p>

Category: Regulatory Examination Procedures

SOURCE	DATE ISSUED	TOPIC	SUMMARY
FFIEC	05/11/2018	Customer Due Diligence - Overview and Examination Procedures	<p>Concurrent with the implementation of the CDD Rule on May 11, 2018, the FFIEC issued updated BSA/AML examination procedures reflecting the requirement that covered financial institutions have risk-based procedures for conducting on-going customer due diligence including:</p> <ol style="list-style-type: none"> 1. Obtaining sufficient information to understand the nature and purpose of a customer relationship and develop a customer risk profile. 2. Conducting ongoing monitoring to identify suspicious activity and on a risk basis, update customer information, including beneficial ownership information of Legal Entity Customers. <p>The <i>FFIEC Manual</i> indicates that policies and procedures should include how customer information will be used to meet other regulatory requirements such as identifying and reporting suspicious activity (e.g., by establishing a baseline by transactions and activities the customer is expected to engage in) and/or complying with Office of Foreign Assets Control requirements (e.g., by identifying and reporting sanctioned individuals and entities).</p> <p>The <i>FFIEC Manual</i> links the concept of a customer risk profile to a customer risk rating, which should be appropriately tailored, according to the financial institution's size and complexity, to distinguish between significant variations in the Money Laundering/Terrorist Financing risk of customers. Procedures and process for developing a customer risk profile should be documented as part of the overall CDD program.</p> <p>For lower-risk customers, the <i>FFIEC Manual</i> now states that a covered institution may have an inherent understanding of the nature and purpose of a customer relationship based on information collected at account opening and that additional information may not necessarily need to be collected on the customer in order to comply with CDD requirements. Furthermore, the <i>FFIEC Manual</i> indicates that additional information should be collected for customers that pose higher risk that should be reviewed more closely and more frequently.</p>

			<p>The manual goes on to state that updating customer information should be driven by events that are identified through the normal course of monitoring. Events should be assessed to determine if a material change to the customer's risk profile is detected. If there is a material change to the customer's profile, it should be updated accordingly and, if the information that changed is relevant in assessing the customer's risk profile/rating, a reassessment of the customer risk rating should be performed. Procedures should indicate when and who is responsible for updating a customer's profile.</p> <p>Link to source:</p> <p>https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf</p>
FFIEC	05/11/2018	Beneficial Ownership of Legal Entity Customers – Overview and Examination Procedures	<p>CDD Rule requirements were incorporated into the <i>FFIEC Manual</i>. As required and defined by the CDD Rule, covered institutions must identify Beneficial Owners of Legal Entity Customers when a new account is opened. Beneficial Owners must be identified under two prongs.</p> <p>The control prong requires the identification of at least one individual who has significant responsibility to control, manage, or direct the Legal Entity Customer. The ownership prong requires the identification of each individual who directly, or indirectly, owns 25% or more of the equity interest of a Legal Entity Customer. Identification of a beneficial owner is not required if no individual owns 25% or more of the Legal Entity Customer. Certain exclusion and exemptions to the Beneficial Ownership requirements apply as defined in the CDD Rule.</p> <p>Covered financial institutions may rely on Beneficial Ownership information that is supplied by the customer, provided that the institution has no knowledge of facts that would call into question the information provided.</p> <p>Beneficial Owners must be identified by obtaining their name, date of birth, address, and identification number. This information can be captured by using a certification form or by other means provided that the individual opening the account on behalf of the Legal Entity Customer certifies that the information obtained is accurate. Procedures must be in place to maintain and update this information.</p>

		<p>Additionally, procedures must be in place for verifying the identity of Beneficial Owners within a reasonable amount of time after an account is opened. Institutions can verify the identity of Beneficial Owners using similar procedures under the institution's CIP Program provided that documentary verification can be performed using photocopies of identification documents.</p>
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Procedures should also include:

1. Processes for when an institution cannot form a reasonable belief that it knows the identity of a Beneficial Owner.
2. Record-keeping requirements to retain identifying information, including the certification form, for a period of five years after a customer's account is closed.
3. Procedures for relying on another financial institution, if the covered institution so chooses, with respect to Beneficial Ownership requirements.

Link to source:

<https://www.ffiec.gov/press/pdf/Beneficial%20Ownership%20Requirements%20for%20Legal%20Entity%20CustomersOverview-FINAL.pdf>



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