



Improving financial transparency:

*Implementation efforts related to the new
Customer Due Diligence Rule*

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Executive summary

On May 11, 2016, the Financial Crimes Enforcement Network (FinCEN) promulgated a final rule under the Bank Secrecy Act (BSA) that clarifies and strengthens existing customer due diligence (CDD) requirements and adds a new mandate regarding the identification and verification of the ultimate beneficial owners (UBOs) of certain legal entity customers (the CDD Rule).¹

The final rule is intended to help financial institutions (FIs) that conduct business in the U.S. avoid illicit transactions by providing greater insight into their customers' identities and business relationships.² FinCEN released its final rule following several years of debate and outreach with the industry and other regulators, and undertook this process as regulators in the U.S. and abroad have been increasing their focus on conforming their anti-money laundering (AML) regimes to international standards and closing loopholes that subject their financial systems to potential abuse. One such loophole is the use by criminals of legal entities to disguise involvement in illicit financial activity. This weakness has been further exposed by recent events, such as the Panama Paper and Paradise Paper scandals.

FinCEN is taking steps to close this loophole by requiring that FIs verify the identity of the UBO of a legal entity customer³ at the time a new account is opened. Additionally, the rule requires that FIs follow certain risk-based procedures for conducting CDD, including conducting ongoing monitoring to identify suspicious activity as well as maintaining and updating customer information. Importantly, the final rule's requirements establish only a baseline for performing CDD, which should be supplemented by the FI's own assessment of each customer's risk profile.

The CDD Rule is the first prescriptive regulatory obligation to know the identity of the UBOs of legal entity customers; thereby, leveling the playing field among FIs. Currently, FIs follow widely divergent CDD practices within and across financial sectors, with many institutions previously lacking any practice to identify such UBOs. The final rule also underscores the fact that CDD continues to remain the cornerstone of a robust AML compliance program. This new rule is considered to be one of the most significant U.S. regulatory developments in recent years, and is likely to be a priority for regulatory supervision and examinations in 2018 and beyond.

FIs have been undertaking massive implementation projects in order to meet the compliance deadline of May 11, 2018. These efforts include enhancing Information Technology (IT) systems to better collect, store, and manage customer information, developing customer risk profiles to perform ongoing monitoring, and communicating the requirements and impact of the new rule to senior management and Board of the Directors (the Board) to properly allocate resources.

With the May 2018 compliance deadline less than six months away, we are sharing the results of our recently concluded benchmarking study covering 50 FIs of varying size and geographic scope regarding their implementation plans related to the CDD Rule.⁴ As a result of this analysis, we found that while the industry has taken significant steps to comply with the CDD Rule ahead of the compliance deadline, questions still remain due to the lack of supplemental guidance from regulatory authorities. Nevertheless, as part of the study, we identified several takeaways and industry leading practices that will assist FIs in making informed decisions on imminent compliance requirements.

1. Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29,398 (May 11, 2016) (codified at 31 C.F.R. pts. 1010, 1020, 1023, 1024, 1026), <https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf>.

2. For additional information, see PwC's [Financial crimes observer, AML: Who is Your Customer? FinCEN Wants You to Know](#) (May 2016).

3. The rule defines a legal entity customer as "a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entity formed under the laws of a foreign jurisdiction that opens an account." However, excluded from this definition, and thus the requirement to identify and verify beneficial ownership information, are sole proprietors and unincorporated associations (e.g., a bowling league). 81 Fed. Reg. at 29,412.

4. Certain FIs may not have participated or responded to one or several questions asked by PwC. All percentages are based on the number of responses received.

Among the key findings:



Industry-wide increase in CDD spend

Our research, which was conducted via in-person and teleconference interviews, revealed that institutions across the board have been increasing their CDD-related spending over the last year. In particular, all of the respondents reported that 2017-2018 CDD budgets have increased by an average of 10-15%. This increase is primarily due to implementation costs in preparing for the new rule (e.g., updates to source systems, revisions to policies and procedures, development of new training materials). Moreover, institutions expect CDD spending to continue to increase as their efforts to identify and verify beneficial owners and conduct ongoing monitoring continue to grow.



The 25% collection threshold is being viewed as a floor and not a ceiling

The CDD Rule requires that FIs identify individuals that directly or indirectly own 25% or more of equity interest of a legal entity customer. However, the majority of FIs surveyed indicated that, for certain higher risk customers, they are planning to drill below the 25% threshold. 52% of respondents will apply a 10% threshold for higher-risk customers, and 6% of the survey participants indicated that they are currently utilizing threshold levels below 25% for all customers, regardless of risk (e.g., 20% or 10%).



For new customers, 75% of the FIs surveyed are requesting information regarding “purpose of the account” to establish a baseline for transaction monitoring purposes

The CDD Rule calls for FIs to understand the “nature and purpose” of customer accounts. Our survey revealed that, while the depth of detail requested by FIs varied, common questions include those related to transaction volume and values, geography or jurisdiction, and use of different products and services. The Rule does not necessarily establish clear guidelines on which risk-based practices and procedures should be implemented to satisfy this requirement; however, by interacting with customers, reviewing historical transactions, leveraging customer data elements, building out Know Your Customer (“KYC”) technology platforms and establishing standards within existing technology platforms, FIs can implement tactical solutions to help mitigate potential CDD risks.



The impact of the CDD Rule is enterprise-wide

Personnel from all lines of business and lines of defense including Client Onboarding, Information Technology, Operations, Internal Audit and Compliance must work in concert to help achieve compliance before the May 11, 2018 deadline. It is imperative that institutions provide robust training to all impacted personnel not only for compliance purposes, but to ensure against disrupting the customer experience.

Overview of the CDD Rule

The CDD Rule requires that covered FIs⁵ identify and verify the UBO of certain legal entity customers at the time a new account is opened. It also requires that FIs implement risk-based procedures for conducting CDD, including conducting ongoing monitoring to identify suspicious activity as well as maintaining and updating customer information.⁶ FinCEN emphasizes that the CDD Rule establishes only a baseline for performing CDD, which should be supplemented by the FI's own assessment of each customer's risk profile. The CDD Rule became effective on July 11, 2016 and covered FIs must comply by May 11, 2018.

By enhancing existing CDD requirements and requiring the identification and verification of UBOs, the CDD Rule reaffirms the four core pillars of an effective BSA/AML and Office of Foreign Assets Control (OFAC)/sanctions compliance program and adds a new fifth pillar that further prevents an institution from being used to facilitate money laundering or terrorist financing. As shown below, the original four core pillars include: (1) a system of internal controls; (2) a dedicated BSA/AML officer; (3) a BSA/AML training program; and (4) an independent testing program.

The fifth pillar, created by FinCEN's imposition of risk-based CDD procedures for conducting ongoing monitoring, is known as the CDD pillar.



According to FinCEN, there are four core elements of CDD:

1. Customer identification and verification;
2. Beneficial ownership identification and verification;
3. Understanding the nature and purpose of customer relationships to develop a customer risk profile; and
4. Ongoing monitoring for reporting suspicious transactions and, on a risk-basis, maintaining and updating customer information.⁷

5. Financial institutions covered by the final rule include banks, broker-dealers in securities, mutual funds, futures commission merchants, and introducing brokers in commodities. 81 Fed. Reg. at 29,398 n.3.

6. Id.

7. Id. at 29,398.

The CDD Rule makes all four of the above CDD elements explicit requirements in a covered FI's AML compliance program and creates minimum standards for all to follow.⁸

Objectives of the CDD Rule

The CDD Rule is intended to help FIs avoid illicit transactions by improving understanding of the potential risks each customer presents. According to FinCEN, there are six ways in which clarifying and enhancing CDD requirements will advance the purposes of the BSA:

1. Assisting investigations by law enforcement;
2. Advancing counter-terrorism and broader national security interests;
3. Improving a financial institution's ability to assess and mitigate risk;
4. Facilitating tax compliance;
5. Promoting clear and consistent expectations and practices; and
6. Advancing the Department of the Treasury's broad strategy to enhance financial transparency of legal entities.⁹

Assisting Investigations by Law Enforcement

Enhanced CDD requirements will help defend against money laundering, corruption, fraud, terrorist financing, and sanctions violations by providing law enforcement with key details about suspected criminals who use legal structures to conceal their illicit activity and assets. Furthermore, legal entity structures that enable its owners to remain anonymous will become more transparent and thus less attractive to bad actors looking to exploit the privacy and confidentiality afforded by previously opaque organizational mazes.¹⁰

"legal entity structures that enable its owners to remain anonymous will become more transparent and thus less attractive to bad actors"

Advancing Counter-Terrorism and Broader National Security Interests

The anonymity provided by certain legal entity structures also enables criminals and national security threats to evade sanctions because the success of such targeted financial measures depends in large part on law enforcement's ability to identify a target's assets and accounts. The CDD Rule aims to reduce the obfuscation of ownership interests by requiring the collection of critical information, such as beneficial ownership.¹¹ As a result, law enforcement and other government regulators will be better able to identify the assets and accounts of a person who is the subject of a sanction.

Improving a Financial Institution's Ability to Assess and Mitigate Risk

Robust CDD practices enable an FI to understand the risks associated with their customers, monitor accounts more effectively, and evaluate activity to determine whether it is unusual or suspicious. Accordingly, explicit baseline requirements that require risk-based procedures for conducting CDD, supplemented by the FI's assessment of each customer's risk profile, will improve a FI's ability to assess and mitigate risk. As a result, the CDD Rule will enhance a FI's ability to make well-informed decisions on whether to onboard a customer, the controls required to effectively mitigate its risk exposure from its customer base, and the reporting of potentially suspicious activity.

8. Id.

9. Id. at 29,399-29,400.

10. Id. at 29,400.

11. Id.

Facilitating Tax Compliance

The information collected under the CDD Rule can be used to assist law enforcement in identifying the true owners of assets and their genuine tax liabilities. Thus, implementation of the CDD Rule will advance the objectives of transparency and information exchange to combat cross-border tax evasion.

"implementation of the CDD Rule will advance the objectives of transparency and information exchange to combat cross-border tax evasion"

Facilitating tax compliance is particularly helpful for the enforcement of the information reporting requirements of the Foreign Account Tax Compliance Act (FATCA), as well as the corresponding reciprocal intergovernmental agreements between the U.S. and foreign governments. FATCA requires foreign FIs to identify entities with substantial U.S. ownership and to report that information to the Internal Revenue Service (IRS). Through intergovernmental agreements, the U.S. has agreed to reciprocate such information exchange by collecting and reporting similar information on the U.S. financial accounts of residents of the partner jurisdiction. As a result, an explicit requirement for financial institutions to collect beneficial ownership information facilitates FATCA compliance because it will make ownership information, including an owner's citizenship, readily available.¹²

Promoting Clear and Consistent Expectations and Practices

Through industry outreach, FinCEN found that FIs agree that CDD is fundamental to mitigating risk and that all institutions implement some form of risk-based CDD practices.¹³ However, FinCEN also found that FIs follow widely divergent CDD practices within and across financial sectors, with many institutions lacking any practice to identify UBOs.¹⁴ The CDD Rule will provide a consolidated and clear CDD framework so that FIs will have well-defined expectations for CDD practices.¹⁵

The CDD Rule will also bring the U.S. in line with other developed AML regulatory regimes because it addresses a weakness identified in the Financial Action Task Force's (FATF) Mutual Evaluation Report of the United States. FATF's report found that a fundamental gap in U.S. AML and counter-terrorist financing measures was the lack of timely access to adequate, accurate, and current beneficial ownership information.¹⁶ FATF additionally notes the prevalence of complex structures, shell or shelf corporations, other forms of legal entities, and trusts, to conceal the source, ownership, and control of illegal funds in the United States.¹⁷ The CDD Rule directly addresses and closes the gaps identified by FATF.

Advancing the Department of the Treasury's Broad Strategy to Enhance Financial Transparency of Legal Entities

Enhancing CDD practices and requiring the disclosure of beneficial ownership information will facilitate the Department of the Treasury's objective of increasing the financial transparency of legal entities.¹⁸ The CDD Rule also complements Congress' intention to adopt legislation that would require the collection of beneficial ownership information at the time that the legal entity is formed in the United States.¹⁹

12. Id. at 29,401. For more information on the convergence of AML and tax regulations, see A new playing field: The convergence of tax regulations with other global risk.

13. 81 Fed. Reg. at 29,401.

14. See note 2.

15. 81 Fed. Reg. at 29,401.

16. Financial Action Task Force, Mutual Evaluation Report, United States 4 (Dec. 2016), <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf>.

17. Id. at 10.

18. 81 Fed. Reg. at 29,401.

19. Id.

Key provisions of the CDD Rule

The CDD Rule requires covered FIs²⁰ to establish procedures that are reasonably designed to identify and verify the UBOs of legal entity customers at the time a new account is opened, subject to some exclusions and exemptions. In addition, procedures must establish a risk-based approach for verifying the identity of each UBO, and contain elements for verifying the identity of customers under applicable customer identification program (CIP) requirements, and for conducting ongoing monitoring.²¹

Definition of UBO

Under the final rule, FIs are required to verify the identity of UBOs of each legal entity customer²² at the time a new account is opened. The final rule employs a two-pronged approach to define beneficial ownership of legal entity customers: (1) ownership prong and (2) control prong.

Ownership Prong

To satisfy the ownership prong, the rule requires covered FIs to identify an UBO that “directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25% or more of the equity interests of a legal entity customer.”²³ It is important to note that there will be circumstances in which no individual meets or exceeds the equity interest threshold for a legal entity customer, and therefore no individual needs to be identified.

In its rule summary, FinCEN commented that covered FIs are generally able to rely upon ownership information provided by the customer, and are not required to affirmatively investigate if equity holders are attempting to evade the reporting threshold, so long as the FI has “no knowledge of facts that would reasonably call into question the reliability of the information.”²⁴

Control Prong

For purposes of satisfying the control prong, the CDD Rule requires covered FIs to identify “[a] single individual with significant responsibility to control, manage, or direct a legal entity customer.”²⁵ The rule provides examples of corporate roles that generally satisfy the control prong, including the Chief Executive Officer, Chief Financial Officer, and Treasurer of a legal entity. FinCEN acknowledged that legal entities vary in structure and organization in its 2016 Frequently Asked Questions, stating more broadly that any “high-level official in the legal entity, who is responsible for how the organization is run, and who will have access to a range of information concerning the day-to-day operations of the company” would ultimately satisfy the control prong.²⁶

With respect to the control prong, covered FIs are required to identify at least one controlling party for each legal entity customer at the time a new account is opened, but have the discretion to identify more as appropriate based on risk.²⁷

20. As stated in footnote two, covered FIs include federally regulated banks and federally insured credit unions, mutual funds, brokers or dealers in securities, futures commission merchants, and introducing brokers in commodities, as defined in 31 CFR 1010.605(e)(1).

21. See 31 CFR 1020.220(a)(2), 31 CFR 1023.220(a)(2), 31 CFR 1024.220, and 31 CFR 1026.220(a)(2) for applicable CIP requirements.

22. See note 4.

23. 81 Fed. Reg. at 29,451.

24. Id. at 29,398.

25. Id. at 29,452.

26. FinCEN, FIN-2016-G003, Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions, 4 (2016) [https://www.ffiec.gov/bsa_aml_infobase/documents/FAQs_for_CDD_Final_Rule_\(7_15_16\).pdf](https://www.ffiec.gov/bsa_aml_infobase/documents/FAQs_for_CDD_Final_Rule_(7_15_16).pdf).

27. 81 Fed. Reg. at 29,417.

Exclusions and exemptions to the CDD Rule

Legal Entity Customer Exclusion

The final CDD Rule includes a comprehensive list of entity types that are excluded from the definition of “legal entity customer” for purposes of the rule. Excluded entities include, in part, those subject to Federal or State regulation and those for which beneficial ownership information is publically available. For example, the rule excludes FIs regulated by a federal functional regulator,²⁸ banks regulated by a state regulator, and entities registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934. In addition, the rule identifies two legal entity types that are subject only to the control prong of the rule, including nonprofit corporations.

For a comprehensive list of excluded and partially excluded entities, please refer to Appendix A.

Notable Exclusions

As is often the case, silence on an important circumstance or scenario can be as important as the actual requirements. Here, the rule is silent on three important scenarios which will impact CDD policy: (1) equivalent exchanges; (2) equivalent regulators; and (3) the exclusion for entities located in jurisdictions in which the regulators maintains UBO information.

A common industry practice leading up to the publication of the CDD Rule was to provide an exemption for the collection of beneficial ownership to legal entity customers that are listed on exchanges equivalent to the American stock exchanges, such as the New York Stock Exchange and NASDAQ. For example, institutions would not require beneficial ownership information to be collected for a company listed on the London Stock Exchange or the Hong Kong Stock Exchange. The CDD Rule is silent on this issue. As a result, and unless further guidance is provided, covered FIs will be required to collect beneficial ownership information for public companies that are not listed in the U.S.

Similarly, many institutions applied an exclusion to legal entity customers whose regulator was equivalent to a federal functional regulator (e.g., the Office of the Comptroller of the Currency) in the U.S. For example, policy at some institutions provided an exemption for companies regulated by the Federal Financial Supervisory Authority in Germany or the Monetary Authority of Singapore. Again, given that the CDD Rule is silent on this scenario, beneficial ownership information will have to be collected in accordance with the rule for companies which are supervised by equivalent regulators unless guidance stating otherwise is issued.

Lastly, the CDD Rule does not include in its definition of legal entity customer “a foreign financial institution established in a jurisdiction where the regulator of such institution maintains beneficial ownership information regarding such institution.”²⁹ While this exclusion seemingly creates an opportunity to exempt the types of customers previously exempted under the concept of “approved regulators,” it does so only in jurisdictions where the regulator maintains beneficial ownership information. However, the CDD Rule is silent as to what jurisdictions fall into this category, creating a legal quagmire for institutions with a significant global footprint.

28. Such regulators include the Federal Reserve, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Securities and Exchange Commission, Commodity Futures Trading Commission, and the National Credit Union Administration.

29. 81 Fed. Reg. at 29,452.

Account Exemptions

FinCEN carved out exemptions for specific account types based on the low risk of money laundering associated with such account types. One such account type includes an account opened to finance insurance premiums and for which payments are remitted directly by the FI to the insurance provider.

For a comprehensive list of account exemptions, please refer to Appendix A.

Identification and verification of beneficial ownership

A key provision of the CDD Rule requires covered FIs to develop and implement procedures that enable them to identify and verify the identity of UBOs of legal entity customers at the time a new account is opened, subject to certain exceptions and exemptions. The identification and verification procedures should be similar to those applied to individual customers under a FI's CIP requirements. However, under the CDD Rule, and contrary to general CIP requirements, the beneficial owner(s) and controlling party are not required to be present at account opening and the institution may rely on photocopies to verify identity.³⁰

"the beneficial owner(s) and controlling party are not required to be present at account opening and the institution may rely on photocopies to verify identity"

While the collection of beneficial ownership and controlling party information is not new for many FIs, the CDD Rule requires the individual opening the account on behalf of the legal entity customer to attest that the information provided is complete and accurate to the best of that individual's knowledge.³² Compliance can be addressed by obtaining the required information on the FinCEN sample certification form (Appendix A to §1010.230³³) or a proprietary form as long as it complies with the substantive requirements of the CDD Rule.

Notably, FinCEN stipulated that covered FIs may rely on the beneficial ownership information supplied by the customer provided that it has no reason to question the reliability of the information provided.³⁴ Additionally, the CDD Rule allows covered FIs to rely on another FI for the performance of these requirements to the same extent as under their CIP rule.³⁵

Amendments to the AML Program requirements

Existing rules require covered FIs to establish AML programs that include four pillars. The final rule adds a "fifth pillar" which calls for covered institutions to adopt risk-based procedures for conducting ongoing customer due diligence.³⁶ This includes process and procedures for:

- Identifying the nature and purpose of the customer relationships; and
- Ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

30. Id. at 29,408.

31. Id.

32. Id. at 29,454.

33. Id. at 29,398.

34. Id. at 29,419.

35. In the executive summary attached to the final rule, FinCEN noted that these risk-based CDD requirements have already been implicitly required. The final rule explicitly codifies these requirements to promote consistency in CDD practices within and across financial sectors.

Nature and Purpose of the Customer Relationship

Covered FIs will now be required to adopt procedures to gain an understanding of the nature and purpose of the customer relationship in order to develop a customer risk profile. A customer risk profile is a collection of information about a customer gathered during account opening that is subsequently used as a reference point against which customer activity may be reviewed for suspicious activity reporting. Such information may include occupation, product type, expected account activity, and other relevant data points.

While covered FIs are not required to incorporate the customer risk profile into transaction monitoring systems (although there are benefits to doing so), they are expected to use this information after a potentially suspicious transaction has been flagged by such a system to determine whether or not the activity is in fact suspicious.

Ongoing Monitoring Requirements

Additional required CDD procedures include maintaining and updating customer information, and conducting ongoing monitoring to identify suspicious activities. During the course of such ongoing monitoring, covered FIs must update beneficial ownership information if new information relevant to the customer risk profile is detected. The new CDD requirements are intended to be a minimum standard for covered FIs to follow and do not reduce the due diligence expectations of federal functional regulators.

PwC CDD Rule benchmarking study

As a key advisor to FIs across the globe, PwC is uniquely situated to understand the challenges FIs are encountering as they work towards compliance. To aid the industry in addressing these challenges head on, we completed a peer group analysis of 50 FIs of varying size and geographic scope in the second half of 2017. As part of this analysis, we obtained information regarding their strategies for implementing the CDD Rule, including methods for collecting beneficial ownership information.

Survey results

The analysis identified that all of the FIs surveyed were already collecting partial, if not all, of the required UBO information. However, given the technology implications, unique requirements such as the certification form and training required for impacted personnel, all FIs are working diligently towards meeting the May 11, 2018 compliance date.

Collection of Beneficial Ownership Information

Who is Responsible for Collecting the Information?

As noted above, many institutions are already collecting beneficial ownership information in some form. However, with the addition of the certification form requirement, institutions will have to examine who in the organization is best suited to collect this information. Not unexpectedly, the survey showed that the group responsible for

collecting beneficial ownership information varied depending on the business lines at the FI. In most instances, the collection function was performed by customer relationship managers or by a centralized KYC/CDD onboarding team. For FIs that had a centralized KYC/CDD onboarding team, the team was found to sit between the business unit and compliance, thereby offering a “1.5” line of defense.³⁶ Notwithstanding the disparate nature of institutions’ KYC apparatus, personnel from all lines of business and lines of defense, including KYC managers, information technology, operations, compliance and internal audit, must work in concert to ensure effective compliance.

What Collection Thresholds are Financial Institutions Using?

Although the CDD Rule does not prescribe a specific ownership threshold for high risk customers, 52% of surveyed institutions already are or will be applying a 10% threshold for high-risk customers. Nearly 78% of U.S.-headquartered financial institutions surveyed indicated that they will strictly apply the 25% threshold specifically dictated by FinCEN. By comparison, all of the foreign banking organizations (FBOs) that were surveyed have indicated that they will continue to collect ownership at the 10% threshold for higher-risk customers. The decision to apply a lower threshold based on customer risk rating appears to be based on several factors: (1) the risk profile of the customer base; (2) organizational structure (i.e., part of a larger organization that applies a lower threshold); (3) standard applied by peer institutions; and (4) expectations expressed by an examiner. The challenge for each institution in making this determination, short of additional guidance provided by FinCEN, is balancing the cold, hard requirements set forth in the CDD Rule against the much fuzzier concept of “regulatory expectation.”

"52% of surveyed institutions already are or will be applying a 10% threshold for high-risk customers"

How are Financial Institutions Collecting the Information?

"37.5% of those surveyed utilize external tools or third-party vendors"

As with any new regulation, an immediate question arises as to the role of technology in making the compliance process more efficient and/or decreasing the cost of compliance. While many institutions have established proprietary tools to help capture beneficial ownership details, 37.5% of those surveyed utilize external tools or third-party vendors. Notably, the addition of technology may help with the customer experience by pre-populating some or all of the information in the certification form, but the individual opening the account on behalf of the legal entity customer will still be required to review and sign³⁷ the form before the account can be opened. Finally, while the CDD Rule does not require FIs to also collect information on intermediary entities (i.e., entities within the ownership structure between the customer and the UBO), the majority of the research participants indicated that they collect this information and screen the entity names, primarily to identify potential sanctions matches. External tools can be useful in identifying these intermediaries.

When Should Financial Institutions Collect the Information?

Finally, the CDD Rule requires beneficial ownership to be identified at the time a new account is opened. The focus on “account” presents a challenge for institutions who perform CDD at the customer level as opposed to the

36. For additional information on the 1.5 line of defense, see PwC’s A closer look, The supervisory framework; building a stronger defense (March 2017).

37. To maintain customer experience, institutions that have the capabilities are accepting virtual signatures (e.g., DocuSign) in addition to “wet” signatures.

account level because it would require the collection of beneficial ownership information every time the customer opens a new account. At institutions where customers have separate accounts for different sales and trading products, the rule would ostensibly require certification each time a new account is opened.

In order to avoid such a circumstance which would undoubtedly create a negative customer experience, the analysis indicates that institutions are designing strategies to prevent this outcome. Some institutions are carefully defining “account” so that the mere addition of the account on the bank’s general ledger does not fall within that definition. Instead, institutions are focusing on true changes in the customer relationship, such as the opening of an account with a different line of business. Alternatively, other institutions are discussing a grace period – a documented time frame during which a new certification is not required, while others are accepting an affirmation via e-mail that no changes in ownership structure have occurred since the form was completed.

Regardless, the strategy employed will impact the periodic review (i.e., customer refresh) process and the enumeration of circumstances which will trigger a periodic review. It is important that institutions update their policies and procedures to include the refresh of beneficial ownership information so that it does not become stale and includes a set of triggers that will not become burdensome on the customer or personnel responsible for collecting this information.

Verification of Beneficial Owner Information

FinCEN notes that covered FIs are generally able to rely upon ownership information provided by the customer, and are not required to affirmatively investigate if equity holders are attempting to evade the reporting threshold, so long as the FI has “no knowledge of facts that would reasonably call into question the reliability of the information.”

Despite the ability to rely on customer-provided information, the analysis also found that some FIs, supplemented the information with external research. Surveyed institutions were found to utilize a mix of documentary and non-documentary methods. Examples of documentary and non-documentary verification include organizational charts signed by the customer, as well as organizational structure information found through research databases such as LexisNexis. Finally, and similar to the practice with other CIP and CDD processes, 88% of the surveyed FIs conduct some form of compliance testing and verification of UBO information in addition to the quality assurance reviews that are part of the institution’s established CDD processes.

"88% of the surveyed FIs conduct some form of compliance testing and verification of UBO information in addition to the quality assurance reviews that are part of the institution’s established CDD processes"

Nature and Purpose of an Account

In addition to collecting UBO information, the CDD Rule also requires FIs to conduct ongoing CDD. A critical component of ongoing CDD is the collection of information regarding the nature and the purpose of the customer account. The analysis found that all of the surveyed FIs asked new customers questions regarding the purpose of the account in order to get a sense of the customer’s expected activities. Varying degrees of detail regarding

nature and purpose of account information were found in KYC records, with most records including geographical or jurisdictional information, data on the products or services to be utilized, and, for existing customers, volume data based on historical information.

While data points may vary across institutions, establishing nature and purpose is an integral step to achieving full compliance and responses from surveyed FIs varied in this category. The CDD Rule does not necessarily establish clear guidelines on which risk-based practices/procedures should be implemented to satisfy this requirement; however, by interacting with customers, reviewing historical transactions, leveraging customer data elements, building out KYC technology platforms and establishing standards within existing technology platforms, covered FIs can implement tactical solutions to help mitigate potential CDD risks.

Clear roles & responsibilities

In order to achieve full compliance with the CDD Rule by the compliance date, leading practice requires increased connectivity between personnel from across the organization. As the first line of defense, business units are in the best position to determine where in the onboarding process information on beneficial ownership, and nature and purpose of the account should be collected. While some lines of business onboard customers in person, others send application packets.³⁸

Compliance and client onboarding teams can convey the impact of the CDD Rule to senior management and the Board of Directors, identifying risks, costs, and plans to address identified gaps. Additionally, Compliance should be taking the lead in educating and training impacted personnel (i.e., those responsible for collecting and verifying beneficial ownership data) on the new requirements so that the entire institution is prepared when the new requirements go into effect.

IT is responsible for enhancing systems to store and analyze the information collected pursuant to the CDD Rule. IT should also ensure that multiple source systems can interact so that a single view of the customer within the FI can be formed. In addition, IT should consider the integration impact of any external tools used to collect beneficial ownership information with internal customer onboarding systems. Although institutions who have already been collecting beneficial ownership information may believe that the required changes from a policy perspective are relatively minor, the technology implications, including System Integration Testing and User Acceptance Testing, should not be underestimated.

38. For additional information on lines of defense, see the publication cited in note 38.



Implications and challenges of implementing the CDD Rule

Overview

The CDD Rule is the first regulation requiring FIs to identify the beneficial owners of their legal entity customers. However, many larger FIs have already enhanced their CDD practices as a result of regulatory pressure ahead of the compliance deadline. Therefore, smaller banks, broker-dealers, and mutual funds that have yet to be subject to regulatory scrutiny will face increased pressure to upgrade their processes at a quicker rate.

Senior management and the institution's Board of Directors should be advised on the implications of the new rule, including necessary funding and allocation of resources, as well as the risks and challenges associated with implementation. Noteworthy risks and challenges include retroactively updating customer profiles, establishing a single view of the customer, and enhancing technology to better collect and store required beneficial ownership information.

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Retroactive updates

FinCEN mandates collection and verification of UBO information for accounts opened as of May 11, 2018. For accounts previously opened, FIs should update customer profiles, including beneficial ownership, on a periodic or event-driven basis. While not explicitly stated, failure to update previously opened accounts on an event-driven or periodic review basis that's consistent with the bank's risk profile may result in regulatory pressure to update all pre-existing accounts, which can be costly and time consuming.

Establishing a single view of a customer

Establishing a single view of the customer means FIs should be able to easily obtain information on their customers across various groups within the institution. Covered institutions are responsible for not only collecting and

maintaining beneficial ownership information, but also using all available resources to establish a risk profile for each customer. The ability to obtain a single customer view will allow investigators to make more informed decisions when it comes to determining whether a customer's activity is suspicious. However, a main challenge institutions face in formulating a holistic view of the customer includes technology updates to allow information to flow across the organization. Furthermore, institutions must be cognizant of data restriction laws which prohibit the flow of certain information from one country or territory to another.

Technology implications

Covered FIs have a responsibility to enhance their IT systems to better collect, store, and manage customer information. Information collected through the CDD process, including new beneficial ownership information, should be readily accessible and searchable. In order to access such information for ongoing account monitoring, transaction monitoring, and OFAC screening, FIs should migrate any data still maintained in paper form to a searchable electronic platform. This will improve data management and provide easier and faster access to information used for due diligence, screening, and monitoring purposes. It will also facilitate better quality information for Suspicious Activity Reports (SARs), Currency Transaction Reports (CTRs), and other required BSA reports.

FIs should conduct an IT impact assessment to determine whether existing systems can be enhanced or whether new IT systems will be necessary. Given the budget cycle of most FIs and the lead time necessary for IT implementation, this is one of the most critical action items that a FI must address, particularly if an outside vendor or other third party is involved. As many mutual funds generally depend on third party transfer agents for back office AML support, such institutions should ensure that the new beneficial ownership requirements are being performed by their service providers.



Conclusion

The CDD Rule is considered to be one of the most significant regulatory developments in recent history and is likely to be a priority for regulatory examinations in 2018. In summary, the rule clarifies and strengthens existing CDD requirements and requires the identification and verification of the UBOs of certain customers. Its primary objectives are to help FIs avert illicit transactions by improving their understanding of the potential risks each customer presents and by increasing their ability to assess a customer's expected activity. The CDD Rule will also assist law enforcement investigations and enforcement efforts by enhancing the transparency of legal entities.

The CDD Rule likely will impact a financial institution's FI's AML compliance program in several ways. Considering the potential regulatory and reputational risks of non-compliance, FIs should take immediate steps to enhance their programs, including:

1. Assessing the overall AML and sanctions program to address the requirements of the CDD Rule;
2. Migrating existing CDD data into a searchable, readily accessible IT platform(s);
3. Ensuring that IT systems provide the required fields to capture UBO information;
4. Enhancing customer risk rating methodologies and AML and sanctions risk assessments to incorporate risks associated with UBO information;
5. Conveying the impact of the CDD Rule to senior management and the Board of Directors, identifying risks, costs, and plans to address identified gaps; and
6. Updating AML policies and procedures, particularly areas including suspicious activity reporting, information sharing pursuant to USA PATRIOT Act Section 314(b), and requests for information (RFI) processes.

Appendix A: exclusions and exemptions

The following entities and accounts are exempt from the CDD Rule definition of legal entity customer.³⁹

Excluded Entities

- A FI regulated by a federal functional regulator or a bank regulated by a State bank regulator;
- A person described in 31 CFR § 1020.315(b)(2) through (5);
- An issuer of a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that is required to file reports under section 15(d) of that Act;
- An investment company, as defined in section 3 of the Investment Company Act of 1940, that is registered with the Securities and Exchange Commission under that Act;
- An investment adviser, as defined in section 202(a)(11) of the Investment Advisers Act of 1940, that is registered with the Securities and Exchange Commission under that Act;
- An exchange or clearing agency, as defined in section 3 of the Securities Exchange Act of 1934, that is registered under section 6 or 17A of that Act;
- Any other entity registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934;
- A registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, each as defined in section 1a of the Commodity Exchange Act, that is registered with the Commodity Futures Trading Commission;
- A public accounting firm registered under section 102 of the Sarbanes-Oxley Act;
- A bank holding company, as defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) or savings and loan holding company, as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C. 1467a(n));
- A pooled investment vehicle that is operated or advised by a FI excluded under paragraph (e)(2) of this section;
- An insurance company that is regulated by a State; and
- A financial market utility designated by the Financial Stability Oversight Council under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
- A foreign FI established in a jurisdiction where the regulator of such institution maintains beneficial ownership information regarding such institution;
- A non-U.S. governmental department, agency or political subdivision that engages only in governmental rather than commercial activities; and
- Any legal entity only to the extent that it opens a private banking account subject to 31 CFR § 1010.620.

39. 81 Fed. Reg. 29,412-19.

- Trusts; however, statutory trusts created by filing with the Secretary of State, or similar office, do fall under the definition of a legal entity customer, and thus the CDD Rule applies.⁴⁰
- Accounts established to finance the purchase or lease of equipment and for which payments are remitted directly by the FI to the vendor or lessor of the equipment.⁴²

Entities Excluded from Ownership Prong

- A pooled investment vehicle that is operated or advised by a FI that is not excluded from the definition of legal entity customer.
- Any legal entity that is established as a nonprofit corporation and has filed its organizational documents with the appropriate State authority as necessary. Such entities include charitable, nonprofit, not-for-profit, nonstock, public benefit or similar corporations.⁴¹

Account Exemptions

The CDD Rule provides that covered FIs are not required to identify and verify UBOs for a legal entity customer when the customer opens any of the following four (4) kinds of accounts:

- Accounts established at point-of-sale to provide credit products, including commercial private label credit cards, solely for the purchase of retail goods and/or services at the associated retailers, up to a limit of US\$50,000;
- Accounts opened to finance the purchase of postage and for which payments are remitted directly by the FI to the provider of the postage products;
- Accounts opened to finance insurance premiums and for which payments are remitted directly by the FI to the insurance provider or broker; and

However, FinCEN added limits to the above exemptions under the following two circumstances:

- The accounts are transaction accounts through which a legal entity customer can make payments to, or receive payments from, third parties; or
- There is a possibility of a case refund for accounts opened to finance purchase of postage, insurance premium, or equipment leasing. If cash refunds are possible, then the covered FI must identify and verify the UBO(s) at the initial remittance or at time of refund.

40. Id. at 29,412.

41. Id. at 29,416.

42. Id. at 29,418.

Contact



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