



## Newsletter Article

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### BENEFICIAL OWNERSHIP: PREPARING FOR THE FINAL RULE

By Sterling Compliance LLC (originally published in Sterling Navigator, Feb 2016. Reprinted with permission)

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Since August 2014, we've been dogged by the specter of expanding BSA requirements to include a fifth "pillar" focused on identifying the beneficial owners of legal entity customers. Why is this relevant now? In December 2015, FinCEN published Regulatory Impact and Flexibility Analyses to support this proposed expansion and we just saw the close of the comment period on January 25, 2016. We are getting closer to a final rule. To effectively plan for the final rule, we must first understand what has been proposed and the impact the expanded requirements may have on current resources.

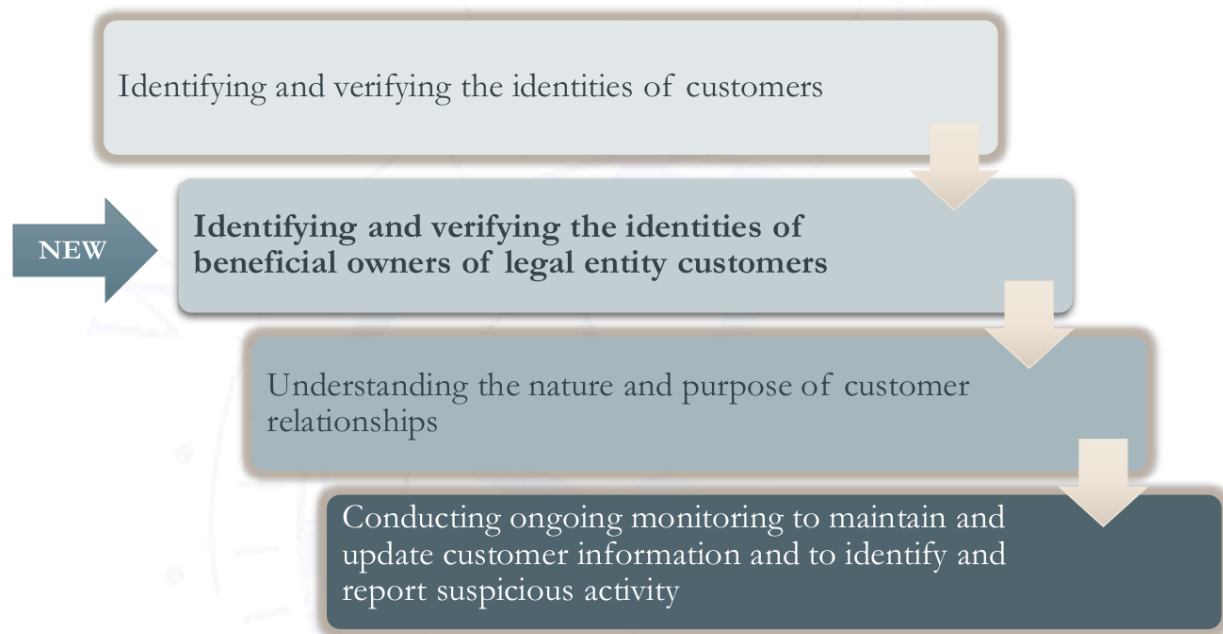
Let's get to the heart of the matter: What does FinCEN and the financial system as a whole stand to gain from the identification of beneficial owners? The final rule states that, "such changes will enhance financial transparency and safeguard the financial system against illicit use. Requiring financial institutions to perform effective [customer due diligence] so that they know their customers – both who they are and what transactions they conduct – is a critical aspect of combating all forms of illicit financial activity, from terrorist financing and sanctions evasion to more traditional financial crimes, including money laundering, fraud and tax evasion...Strong CDD practices that include identifying the natural persons behind a legal entity help defend against these abuses in a variety of ways. Armed with beneficial ownership information, financial institutions can provide law enforcement with key details about the legal structures used by suspected criminals to conceal their illicit activity and assets. Moreover, by requiring legal entities seeking access to financial institutions to disclose identifying information such as the name, date of birth and social security number of a natural person, will make such entities more transparent and this less attractive to criminals and those who assist them."

**Beneficial ownership information is critical to addressing basic risks like OFAC and FCPA that can result in serious enforcement actions for failing to address these risks.**

*Michael Volkov, The Volkov Law Group  
Beneficial Ownership: Sanctions and FCPA Compliance  
January 26, 2016*

Michael Volkov<sup>1</sup> recently penned an article that was published through [JDSupra Business Advisor](#) that brought to light additional reasons why the collection of beneficial ownership can serve your purposes. Mr. Volkov notes, “In general, businesses have other reasons to secure beneficial ownership information. One key concern is sanctions compliance. To the extent that an account holder engages in international transactions, financial institutions need to know the beneficial owners of the account holder in order to comply with OFAC sanctions requirements or to conduct meaningful due diligence of the account...From an FCPA<sup>2</sup> perspective, a company has to identify the beneficial owners of its third party intermediaries...OFAC and FCPA risks are significant, but so are reputational risks. Dealing with a controversial individual who owns a company can create real and significant harm to a company’s reputation.”

For the most part, the elements that FinCEN has cited as being key to effective customer due diligence are standard practice for many community banks as highlighted below. **Combined, these elements comprise the minimum standard of customer due diligence.**



Under the proposed amendment, FinCEN would modify its existing rules to so that each pillar is explicitly referenced in corresponding requirements within FinCEN’s program rules. The first element – identifying and verifying the identities of customers – is already addressed within Customer Identification Program rules. The three remaining elements would be addressed by two rule changes:

- 1) The implementation of a specific requirement to collect beneficial owner information on the natural persons behind legal entities, subject to specific exemptions.
- 2) The addition of explicit CDD requirements that would address understanding the nature and purpose of customer relationships and conducting ongoing monitoring.

What then, would be your requirements? The first requirement would be to verify the identity of beneficial owners of legal entity customers consistent with your established CIP procedures. Many community banks have already incorporated this practice into their Customer Identification Programs. Examples of legal entity customers would include corporations, partnerships or other similar business entities that open an account after this rule becomes effective. In other words, FinCEN is not requiring you to go back and verify the identity of beneficial owners of your existing

account relationships with legal entities. However, if any of these entities were to open new accounts with your institution, the identification of beneficial owners would come into play.

As we would expect, there are exemptions to this rule. FinCEN proposes to exempt from the beneficial ownership requirement entities that are currently exempt from customer identification requirements under the CIP rules. Exemptions would include: federally regulated banks, brokers or dealers in securities, mutual funds, futures commission merchants and introducing brokers in commodities, publicly held companies, domestic government agencies and instrumentalities and certain legal entities that exercise government authority. Other proposed exemptions are focused on issuers of a class of securities, investment companies, public accounting firms, and the like.

While certain entities would be exempt under the proposed rule that exemption does not imply that such entities pose a low risk of money laundering or terrorist financing.

For the purposes of this rule, a beneficial owner has been defined as a natural person (as opposed to another legal entity). To aid in the determination of who meets the definition of a beneficial owner, FinCEN has provided for a two-prong test. **Each prong is intended to be an independent test.**

## OWNERSHIP PRONG

**Each** individual, who directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns **25% or more** of the equity interests of a legal entity customer.

## CONTROL PRONG

An **individual** with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer (CEO, CFO, COO, Managing Member, General Partner, President, Vice President or Treasurer) OR any other individual who performs similar functions.

In cases where an individual is both a 25% owner and meets the definition for control, that same individual could be identified as a beneficial owner under both prongs. You may also identify other individuals that technically fall outside the proposed definition of “beneficial owner” in accordance with your risk mitigation and customer due diligence practices. Similarly, you might be aware of an individual who effectively controls a legal entity customer through a substantial debt position. While that type of control has not been incorporated into the control prong, you are not precluded from identifying them and verifying their identity, when appropriate.

A secondary requirement under the proposed rule provides for customer certification: at the time of account opening, the individual opening the account on behalf of the legal entity customer would be required to complete a standard certification form. We have provided a **Beneficial Ownership Standard Certification Form** as an accompanying tool to this edition of the Navigator for your convenience. The form was designed using FinCEN’s model form as a basis.

Please Note: Under this rule, you would be required to verify the identity of beneficial owners – NOT verify whether they are, in fact, the beneficial owners (i.e. the individual’s status as a beneficial owner).

This brings us to understanding the nature and purpose of customer relationships and ongoing monitoring. Good news: FinCEN does not intend for this element to require modification of your existing practices. This amendment would clarify existing regulatory expectations for financial institutions to understanding the

nature of an account relationship so that unusual or suspicious transactions may be readily identified. More good news: The fourth element – ongoing monitoring – is something you are already doing as well. As such, FinCEN expects that you would satisfy this element by continuing your ongoing monitoring practices, consistent with existing guidance and regulatory expectations.

For our community banks, this proposal does not deviate much from conducting business as usual. There will be an additional level to the account opening process for legal entity customers and documenting the beneficial ownership information. Training will need to be conducted to ensure all account opening personnel have a good understanding of the two-prong beneficial ownership tests and how to apply those tests during initial account opening discussions. Beneficial ownership certification forms will have to be completed and obtained at the time of account opening. Depending on the complexity of your customers' business structures, you may or may not have an increased burden in monitoring your beneficial owners. For non-complex structures, you could likely capture your beneficial owners within your ongoing monitoring processes and effectively identify any fluctuations or anomalies in transaction activity. However, you must also consider more complex business structures and the circumstances that will ultimately arise. For example, if I am a beneficial owner of Business A under the control prong, a beneficial owner of Business B under the ownership prong and then I hold a significant debt position over Business C, how do you tie all that activity together for monitoring purposes? Therein lies a primary challenge of this proposed rule.

**The silver lining is that the rule is not yet finalized. You have time to consider the likelihood of complex business structures or relationships given your current customer base. You have time to evaluate your current identification, verification and monitoring processes to determine whether changes may be warranted. You have time to train your staff. All of these actions will be critical to meeting the rule's requirements head on.**

<sup>1</sup> The Volkov Law Group

<sup>2</sup> Foreign Corrupt Practices Act

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