

## Investigations, Compliance and Defense

# FinCEN's New Rule Setting Forth Minimum Standards for Financial Institutions to Identify Beneficial Owners Now In Effect

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Earlier this week, the Financial Crimes Enforcement Network (FinCEN), an agency of the US Treasury, put into effect a new customer due diligence rule under the anti-money laundering provisions of the Bank Secrecy Act. The new rule (the CDD Rule) sets forth the minimum standards for financial institutions to collect and verify the identity of natural persons, or "beneficial owners," who own, control, and profit from companies that open new accounts at US banks, mutual funds, brokers or dealers in securities, futures commission merchants, and brokers in commodities.

The CDD Rule was finalized in 2016 and allowed for a two-year implementation period which expired this week. Of greatest importance, the CDD Rule requires financial institutions that are subject to the Bank Secrecy Act to create and maintain written policies and procedures that are reasonably designed to identify and verify the identities of beneficial owners of legal entity customers that open new accounts. The CDD Rule defines legal entities as corporations, limited liability companies, and other entities that are created by filing a public document with a Secretary of State or similar office, and general partnerships or other similar business entities formed in the United States or a foreign country. According to the Federal Financial Institutions Examination Council, foreign and domestic legal entities can be used to facilitate money laundering because their true ownership can be concealed. Information about the beneficial owners of these customers can help law enforcement identify criminals who use legal entity structures to conceal money laundering and illegal assets.

Before opening an account for a legal entity customer, covered financial institutions must now identify and verify the identity of any beneficial owner, meaning a natural person who owns 25% or more of a legal entity customer, or any single individual who exercises significant responsibility to control, manage, or direct a legal entity customer. For example, a company wishing to borrow money for a construction project approaches a regional bank. Under the CDD rule, the bank must collect from the company the identities of any beneficial owners before any account is opened at the bank. The bank does not need to independently investigate the company's ownership structure. Rather, the bank can rely on the information provided by the company to the bank, assuming that the bank does not know of facts that would cause it to doubt the reliability of the company's disclosure. If the bank does have any doubts, it must further investigate the company's ownership structure or decline to open the account and lend any funds for the project.

The CDD Rule also requires financial institutions to understand the nature and purpose of its customer relationships, to develop risk profiles for its customers, and to conduct ongoing monitoring to identify and report suspicious transactions. In addition, the CDD Rule requires financial institutions to maintain and update customer information, including regarding the beneficial owner or owners of a legal entity.

FinCEN's guidance also makes clear that covered financial institutions must implement procedures for verifying the identity of beneficial owners of a legal entity customer, including by describing when the institution will require documentary verification (e.g., government-issued identification bearing a photograph), non-documentary verification (e.g., contacting a beneficial owner, independently comparing information provided by the legal entity customer's representative with information from other sources such as FBI and OFAC watch lists, and checking references with other financial institutions), or a combination of both methods. Financial institutions may satisfy the verification requirement by using a

certification form completed by the individual opening the account on behalf of the legal entity customer. FinCEN guidance also emphasizes that when the beneficial owner of the company seeking to open the account is itself a legal entity, the financial institution must ultimately identify the natural person or persons who own the legal entity that holds equity in the customer company.

With the CDD Rule now in effect, financial institutions can expect to see additional scrutiny by FinCEN of their policies and procedures to examine beneficial owners. Banks will have time, however, to adjust to the new rule. FinCEN Director Kenneth A. Blanco recently said FinCEN understood there would be a time period of adjustment and FinCEN was asking for a “good-faith effort to comply” with the new rule. Smaller and regional banks may be particularly focused right now on developing procedures to comply with the new rule.



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