

You Have Less Than a Year—Will You Be Ready?

On May 11, 2016, FinCEN published anti-money laundering rules for entities. These rules will go into effect May 11, 2018. Unlike so many other rules, these are relatively simple, but promise to create a substantial operational burden for financial institutions. There will be no "easy fix" programming solution for this one. Financial institutions are now going to have to implement procedures to identify and verify the beneficial owners of a legal entity at the time a new account is opened. In addition to this new "Beneficial Ownership" requirement, financial institutions are going to have to implement risk-based procedures for conducting on-going diligence and monitoring to identify suspicious activity involving the beneficial owner(s), and to update beneficial ownership information based on risk assessments. The balance of this piece is intended to provide a high-level overview of the two beneficial ownership tests and the on-going risk-based diligence requirements.

Beneficial Owner

Financial institutions dealing with entities will need to evaluate ownership and control of that entity. A "beneficial owner" includes:

- A. Each individual who, directly or indirectly, owns 25% or more of the equity interests of the legal entity; and/or
- B. A single individual with significant responsibility to control, manage, or direct the legal entity.

Generally, there must be at least one beneficial owner identified under the control test, and there could be as many as four beneficial owners identified under the ownership test (i.e., if four individuals each own 25%). It is worth noting that the rule requires that you "look through" multiple tiers or layers of ownership until you find one or more natural persons. For example, if Company A is our customer and it's owned by Company B, which is owned by Company C, and Mrs. Smith owns 25% of Company C, she indirectly owns 25% of Company A, and would be our "beneficial owner." Working through complex and private ownership structures could be a significant operational burden for financial institutions going forward.

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Entity

An entity for purposes of FinCEN's new rule, subject to certain limited exclusions, includes: (a) entities created by filing a public document with the Secretary of State (or equivalent), such as a corporation, LLC or certain business trusts; and (b) partnerships. Entities not covered by the rule include: (i) those listed on a stock exchange (New York Stock Exchange, NASDAQ or American); (ii) banking organizations; (iii) SEC-registered investment companies and advisers; (iv) state-regulated insurance companies; (v) CFTC registered entities; (vi) sole proprietorships; (vii) unincorporated associations; (viii) governmental entities; and (ix) most trusts.

Account

Account has the same definition currently in the CIP rules for financial institutions.

Requirements

Financial institutions must implement a program that uses the same elements required under existing CIP to identify and monitor beneficial owners. Among other things, you must use documentary and non-documentary methods for collecting and verifying customer information. You must also retain the records for five (5) years after the account is closed. Financial institutions may rely on information provided by third parties, so long as the reliance is reasonable. FinCEN acknowledged that the beneficial owner may not be present at account opening, and requiring them to be would pose operational challenges. This will create significant documentation and retention burdens for financial institutions going forward.

Ongoing Risk-Based Diligence and Monitoring

Financial institutions will be required to conduct ongoing monitoring to identify suspicious transactions (thus necessitating risk assessments to determine normal activity), and have procedures in place for updating information regarding beneficial owners. Think about that last piece for a moment. You will need to have mechanisms in place to identify when someone becomes a 25% equity owner or there are changes in control of your entity customer. FinCEN kindly makes clear that this does not require "continuous or periodic" reviews, but does impose a requirement to have procedures to capture "event-driven" changes. In the



ordinary course of monitoring your entity customers, there will be certain "triggers" that necessitate updates to your beneficial ownership information.

What Now?

While there is a year left before this rule goes into effect, we believe it is going to require significant time and planning on the part of financial institutions to consider the impact and put procedures in place to comply. Furthermore, and perhaps more challenging, we believe there will be significant push-back from customers. As such, it will be wise and beneficial (pun intended) to get out in front of this change and begin communicating early and often with entity customers that this is coming. You need to prepare them for the additional and invasive diligence that will be required. The earlier you can work with your customers, the easier it will be to begin gathering this information. This will be a drastic change for many entities that are not accustomed to sharing this information and may be protective and reluctant to cooperate.

This information is not intended as legal advice. You should seek specific legal advice before acting on the information contained herein.

For more information on the new FinCEN rules and requirements, contact [Melissa York](#) at mlanska@reinhartlaw.com or 414-298-8706, or [John Reichert](#) at jreichert@reinhartlaw.com or 414-298-8445.

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