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Know Your Customers (Especially the Ones That You Don't Know)

The Financial Crimes Enforcement Network (FinCEN) recently issued new guidance to financial institutions regarding certain customer relationships, which was co-signed by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Securities and Exchange Commission. The guidance's purpose was to clarify "regulatory expectations for obtaining beneficial ownership information for certain accounts and customer relationships." The following is intended to be a "plain English" summary of the guidance. It is not a substitute for the guidance and you should refer to the guidance to answer any question about what its expectations are.

Generally speaking, the guidance encourages institutions to adopt procedures that identify customers who pose a high risk for money laundering and terrorist financing. Heightened risk can arise from persons or entities that actually control and manage the assets in the account. Because of the potential for abuse by these beneficial owners, FinCEN offered the following examples of customers who might pose a higher risk:

- customers who act as agents for others;
- legal entities not publicly traded in the United States; and
- customers who are trustees.

The guidance summarizes some of the due diligence requirements that financial institutions must follow to help identify and monitor these higher risk customers.

Customer Due Diligence

The first line of defense against possible illicit activities by customers is a comprehensive customer due diligence program consisting of policies and staff to implement the policies. The guidance states that these policies "should be developed to identify customers who pose heightened money laundering or terrorist financing risks."

- For customers who are agents of others, the policy should allow the institution to find out on whose behalf the customer is acting.
- For foreign entities, the policy should allow the institution to obtain information about the entity's structure and ownership.
- For trustees, the institution should gather information about the trust structure and find out who has control over the funds and the trustee.
- Financial institutions should implement this program across all their business lines. The institution's staff that is responsible for implementing these policies should ensure that all information is cross-checked with other business areas within the institution.

Enhanced Due Diligence

Once an account has been identified as posing a heightened risk, the account should undergo the institution's enhanced due diligence procedures. These procedures allow the institution to take steps to "reasonably":

- verify the identity of beneficial owners;
- understand the source and use of funds in the account;
- understand the relationship between the customer and beneficial owner; and
- institutions should also monitor these accounts on an ongoing basis to ensure that the information initially received regarding the intended purpose of the account matches the sources of the funds and the uses of the account.

Other Types of Due Diligence

Financial institutions should take reasonable steps to determine the source of any private banking customers' wealth and the activity of those accounts. Institutions should also take steps to detect any suspected money laundering activity in "correspondent accounts" established for foreign financial institutions. Failure to establish proper due diligence in these areas could result in a violation of the anti-money laundering regulations.

Bottom Line: Know Your Customer

Most of the information contained in the guidance was previously issued in the Bank Secrecy Act and the anti-money laundering statutes. The major theme of the guidance is merely that financial institutions should make every reasonable effort to know their customers. Extra precautions should be taken to know customers who pose a higher risk of money laundering or terrorist financing. Simply knowing the customers who do not pose a risk is not enough. But identifying which customers may be potential terrorist sympathizers or money launderers can be difficult if not impossible. Staff members of financial institutions should work to identify accounts that are named for agents, trustees or foreign entities, but which are beneficially owned by other persons or entities who actually manage and control the account's assets. Institutions have the responsibility to delve deeply enough into the structure and financing of these higher risk customers to try to detect and report any illicit activity. The bottom line is each financial institution should know its customers (especially the ones that it does not know).

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