

CLIENT ALERT /// April 2, 2020

FATF Upgrades U.S. Customer Due Diligence Regime

On March 31st the Financial Action Task Force (FATF)—the global AML/CFT standard-setting body and watchdog—announced that it has upgraded the United States for technical compliance with FATF Recommendation 10 following implementation of the U.S. Treasury’s new customer due diligence (CDD) requirements.¹ FATF’s re-rating—from “partially compliant” to “largely compliant”—reflects a great deal of hard work and progress by the United States to address CDD deficiencies identified in its 2016 Mutual Evaluation Report (MER), including its lack of requirements for financial institutions to ascertain and verify the identity of beneficial owners.

- The lack of timely access by regulators and law enforcement to “adequate, accurate, and current beneficial ownership information” was cited in the 2016 MER as “one of the fundamental gaps” in the U.S. anti-money laundering (AML)/combatting the financing of terrorism (CFT) regime, raising “significant concerns.”²
- U.S. authorities largely addressed these shortcomings through the issuance in May 2016, and implementation in May 2018, of new Customer Due Diligence Requirements for Financial Institutions, commonly known as the “CDD Rule.”³
- Under the CDD Rule, covered U.S. financial institutions are required to establish and maintain written procedures that are reasonably designed to identify and verify the identities of the individuals who own or control their legal entity customers, such as corporations and limited liability companies.⁴
- Notwithstanding the importance of the CDD Rule, certain U.S. shortcomings under Recommendation 10 remain, including: (i) the failure to extend CDD requirements directly to trusts; and (ii) the ongoing lack of CDD obligations for investment advisors, insurance companies, or money services businesses (MSBs)—particularly when such MSBs conduct transactions beneath the \$3,000 customer identification threshold for occasional customers in the United States.

FATF’s report further improves upon the strong ratings earned by the United States, but there is still important work to be done—particularly regarding the transparency of legal persons and arrangements created in the United States and AML regulation of certain high risk businesses and professions. The United States is now “compliant” or “largely compliant” with 31 out of the 40 FATF Recommendations,

but is still rated “partially compliant” with five and “non-compliant” with four of the Recommendations.⁵ Of particular importance are the following remaining deficiencies in the U.S. AML/CFT regime:

- The United States is still not compliant with Recommendation 24 and only partially compliant with Recommendation 25, regarding transparency and beneficial ownership of legal persons and legal arrangements, respectively. Addressing these fundamental shortcomings requires clear, strong action by the U.S. Congress. To address these concerns with respect to legal persons and prevent the formation of anonymous companies outright, U.S. lawmakers are actively considering new legislation—such as the Corporate Transparency Act, passed by the U.S. House of Representatives in June 2019—that would require the disclosure of beneficial ownership directly to regulators at company formation and on an annual basis thereafter.⁶
- The United States is still not compliant with Recommendations 22, 23, and 28, regarding the regulation and supervision of designated non-financial businesses and professions (DNFBPs). In particular, the failure to extend AML preventive measures to trust and company service providers, lawyers, and accountants when such professionals are engaged in certain financial or business activities for their clients continues to present a significant vulnerability in the U.S. AML/CFT regime. Addressing these fundamental shortcomings also requires clear, strong action by the U.S. Congress. Some of the new legislation being considered by the Congress to require disclosure of beneficial ownership of companies created in the United States would also extend certain AML regulations to company formation agents—including trust and company service providers, attorneys, and accountants when performing these services on behalf of their clients.

FATF’s action has important implications for jurisdictional authorities, financial institutions, and non-financial businesses alike. FATF’s follow-up report:

- Demonstrates the general importance of jurisdictional efforts to continue strengthening their AML/CFT regimes after undergoing FATF assessments;
- Underscores the particular importance of clear beneficial ownership and ongoing CDD requirements as essential preventive measures protecting the integrity of the international financial system; and
- Indicates that full coverage of a jurisdiction’s financial system—including non-bank financial institutions (NBFIs) and DNFBPs—is essential to earning ratings of full technical compliance with FATF AML/CFT standards.



Endnotes

¹ FATF, *Anti-Money Laundering and Counter-Terrorist Financing Measures – United States*, 3rd Enhanced Follow-Up Report and Technical Compliance Re-Rating, March 2020, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/fur/Follow-Up-Report-United-States-March-2020.pdf>.

² FATF, *Anti-Money Laundering and Counter-Terrorist Financing Measures – United States*, Fourth Round Mutual Evaluation Report, December 2016, at 4, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf>.

³ Financial Crimes Enforcement Network (FinCEN), Customer Due Diligence Requirements for Financial Institutions, available at: <https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf>. See also 31 CFR §1010.230 (Beneficial ownership requirements for legal entity customers). FATF notes in its follow-up report that “a few minor technical gaps remain” with respect to Recommendation 10, including the lack of explicit beneficial ownership requirements “in relation to other trust relevant parties for legal arrangements” and the failure to directly subject investment advisers to Bank Secrecy Act obligations. See FATF, *Anti-Money Laundering and Counter-Terrorist Financing Measures – United States*, 3rd Enhanced Follow-Up Report and Technical Compliance Re-Rating, March 2020, at 3, available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/fur/Follow-Up-Report-United-States-March-2020.pdf>.

⁴ FinCEN, Customer Due Diligence Requirements for Financial Institutions, available at: <https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf>. See also 31 CFR §1010.230 (Beneficial ownership requirements for legal entity customers).

⁵ The United States is still rated as “partially compliant” with Recommendations 1 (assessing risks and applying a risk-based approach), 12 (politically exposed persons), 16 (wire transfers), 20 (reporting of suspicious transactions), and 25 (transparency and beneficial ownership of legal arrangements) and as “non-compliant” with Recommendations 22 (DNFBPs: customer due diligence), 23 (DNFBPs: other measures), 24 (transparency and beneficial ownership of legal persons), and 28 (regulation and supervision of DNFBPs).

⁶ See H.R. 2513, full text available at: <https://www.congress.gov/116/bills/hr2513/BILLS-116hr2513rfs.pdf>.