

June 8, 2018

Vol. XXXV, No. 13

CUSTOMER DUE DILIGENCE – BENEFICIAL OWNERSHIP REQUIREMENTS FOR LEGAL ENTITY CUSTOMERS

I. INTRODUCTION – EXCEPTIVE RELIEF

Under 31 U.S.C. § 5318(a)(5) and 31 CFR § 1010.970, FinCEN has the authority to make exceptions to the requirements of 31 CFR Chapter X. Such exceptions may be either conditional or unconditional and may apply to particular persons or classes of persons, but only to the extent that such limits are expressly stated in the order of authorization. Exceptions may be revoked at FinCEN’s discretion.

II. PRODUCTS AND SERVICES WITH AUTOMATIC ROLLOVER OR RENEWALS

The Financial Crimes Enforcement Network (FinCEN) has issued a ruling to provide a 90-day limited exceptive relief to covered financial institutions from the obligations of the Beneficial Ownership Requirements for Legal Entity Customers (Beneficial Ownership Rule) with respect to certain financial products and services that automatically rollover or renew (i.e., certificate of deposit (CD) or loan accounts) and were established before the Beneficial Ownership Rule’s Applicability Date, May 11, 2018. This exception begins, retroactively, on May 11, 2018, and will expire on August 9, 2018. During this time, FinCEN will determine whether and to what extent additional exceptive relief may be appropriate for such financial products and services that were established before May 11, 2018, but are expected to rollover or renew after such date.

Consistent with the definition of “account” in the Customer Identification Program (CIP) rules and subsequent interagency guidance, each time a loan is renewed or a certificate of deposit is rolled over, the bank establishes another formal banking relationship and a new account is created. As clarified in the Customer Due Diligence Frequently Asked Questions published on April 3, 2018, covered financial institutions are required to obtain information on the beneficial owners of a legal entity that opens a new account for each new formal banking relationship established, even if the legal entity is an existing customer. FinCEN understands that some covered institutions have not treated such rollovers or renewals as new accounts and have established automatic processes to continue the banking relationship with the customer. These covered financial institutions have expressed concern regarding their ability to comply with the Beneficial Ownership Rule with respect to such accounts.

FinCEN believes that further consideration of this issue is appropriate and is, therefore, granting this temporary exception with respect to collecting beneficial ownership on certain financial products and services (i.e., CD and loan accounts) that automatically rollover or renew and were established before the Beneficial Ownership Rule's Applicability Date.

III. PREMIUM FINANCE CASH REFUNDS

A. *Introduction*

The Financial Crimes Enforcement Network (FinCEN) has issued a ruling to provide exceptive relief to covered financial institutions with respect to the application of the Beneficial Ownership Requirements for Legal Entity Customers (Beneficial Ownership Rule) to premium finance lending products that allow for cash refunds. Premium finance lenders provide loans to businesses to cover insurance premiums. In the normal course of business, premium finance lenders process a significant number of cash refunds each year. The Beneficial Ownership Rule currently exempts covered financial institutions from the requirements to identify and verify the identity of the beneficial owner of legal entity customers at account opening to the extent that the legal entity customer opens the account for the purpose of financing insurance premiums and for which payments are remitted directly by the financial institution to the insurance provider or broker unless there is a possibility of cash refunds. **This ruling provides exceptive relief to covered financial institutions from the requirements to collect and verify the beneficial owner of a legal entity customer opening such premium financing account when there is a possibility of a cash refund.**

B. *Background*

Businesses of all sizes typically obtain commercial, property, casualty, and liability insurance policies to mitigate operational risks. While some businesses are able to purchase these policies outright, others either do not have sufficient funds to cover the premiums or prefer to finance the purchase of such policies for other reasons, such as to manage their cash flow. In these circumstances, many businesses engage the services of premium finance lenders falling within the scope of FinCEN's regulations.

Premium finance lenders provide short-term loans to help businesses cover their annual insurance premiums by making an advance payment, in full, directly to the insurance carrier. Premium finance lenders typically do not interact directly with the borrower; rather, they interact directly with insurance agents or brokers, who bring financing opportunities to the borrowers, and with whom they have direct contact.

Premium finance lenders pay the loan proceeds (i.e., the insurance premium) directly to the insurance agent or broker arranging the loan transaction or to the insurance company issuing the policy.

FinCEN exempted, subject to certain limitations, accounts established to finance insurance premiums from the Beneficial Ownership Rule, because of the low risk of money laundering presented by these loans. The structural characteristics of premium finance lending and the purpose for which premium finance accounts are established limit

a legal entity customer's ability to use the accounts for any other purpose. The exemption as drafted in the rule, however, does not apply if there is a possibility of a cash refund on the account activity, in which case the beneficial owner of the legal entity customer must be identified and verified for such accounts.

C. Analysis

Premium finance lending is an automated high-volume industry, with companies routinely processing a significant number of cash refunds each year in the normal course of business. Premium finance lenders process refunds on a significant number of their loans, which could limit the applicability of the regulatory exemption.

Moreover, state laws may require premium finance companies to refund promptly, to either a customer, or a customer's insurance broker or agent, any excess funds that the company has not earned.

In the normal course of business, a premium finance company may be required to refund funds when:

1. unearned interest has accrued, such as when a borrower repays the loan prior to the loan's maturity date;
2. a borrower has made inadvertent overpayments, such as when the borrower forgets to terminate prescheduled automated payments and accidentally makes an extra payment after the loan has been repaid; or
3. policies are cancelled, at which point any unearned premiums exceeding the loan amount, earned interest, or fees must be forwarded to the borrower and/or the borrower's agent or broker.

These types of cash refunds do not pose significant money laundering and terrorist financing risks. The processes for premium finance lending appear to be highly automated, and cash loan refunds are typically generated from an accounting transaction to correct an inadvertent error(s). Moreover, in many cases, state law requires that the refund be returned directly to the customer or their broker or agent. These structural characteristics of premium finance refunds further make them low risk for money laundering and terrorist financing activity. FinCEN has confirmed the low money laundering risk nature of these transactions, notwithstanding the potential for these types of cash refunds, through discussions with law enforcement.

To the extent premium financing involving cash refunds carries a minimal risk of money laundering and terrorist financing, that risk will be mitigated by the requirement that covered financial institutions are required to comply with other BSA/AML reporting requirements. For example, covered premium finance lenders have a responsibility to report suspicious activity when a refund may not have an economic purpose or has other indicators of suspicious activity.

Therefore, because of the low risk of significant money laundering and terrorist financing posed by premium finance lending potentially involving the above referenced types of cash refunds, and the fact that FinCEN and law enforcement can still be alerted to

potentially more problematic transactions through other reporting requirements, exceptive relief from the beneficial ownership requirements is appropriate in the context of premium finance arrangements, notwithstanding the potential for cash refunds as part of the arrangement, provided that such refunds are only remitted directly to the borrower or the borrower's agent or broker.

FinCEN had placed limits on the exemption in its rule based on concerns that products involving cash refunds could be subject to misuse and might be used as instruments for money laundering. Based on its current understanding from industry and law enforcement that the business practices surrounding such cash refunds limit such risks, FinCEN is issuing this exceptive relief. However, as with any other exceptive relief, FinCEN may withdraw or modify this exceptive relief under any circumstances, particularly if FinCEN receives new or different information involving (1) the manner in which premium financing operates; (2) the risks of money laundering and terrorist financing associated with premium finance lending that incorporates the potential for cash refunds; and, (3) the value of information that would otherwise be collected but for the existence of this exception.

Accordingly, for the reasons discussed above, FinCEN is granting exceptive relief to premium finance lenders whose payments are remitted directly to the insurance provider or broker from the requirements of the Beneficial Ownership Rule to identify and verify beneficial ownership information even in situations where such lending involves the potential for cash refunds. FinCEN also reminds covered financial institutions of their obligation to comply with all other applicable BSA/AML requirements, including the filing of suspicious activity reports.

The foregoing Compliance Update is for informational purposes only and does not constitute legal advice. As a reminder, the NBA general counsel is the attorney for the Nebraska Bankers Association, not its member banks. The general counsel is available to assist members with finding resources to help answer their questions. However, for specific legal advice about specific situations, members must consult and retain their own attorney.