



**KNOW YOUR CUSTOMER – WHAT  
VERIFICATION AND FRAUD CONTROL  
STRATEGIES SHOULD LENDERS CONSIDER  
EFFECTIVE IN TODAY’S ECONOMY?**

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## KYC Basics

- KYC = Know Your Customer
- Generally required for compliance with Bank Secrecy Act (BSA) or other anti-money laundering (AML) rules
- Obtaining customer information before executing transactions
- Business tension between ease of customer uptake and compliance

... But you know all this

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## KYC & Fraud Controls – An FTC Focus

- In the past decade, FTC has sued 3 of the largest money transmitters for permitting scam victims to send payments to scammers
- Huge cases - \$18mm, \$125mm, and \$586mm
- Key themes
  - Failure to supervise agents
  - AML program fails to prevent fraud
  - Consumer complaints demonstrate fraud
  - Excerpts from bad documents

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## Legal Theories

- Section 5 of the FTC Act
  - “Unfair” Practice
    - Substantial consumer injury
    - Not reasonably avoidable
    - Benefits of the practice do not outweigh the injury
  - Actus Reus: Failure to take timely, appropriate and effective action to detect and prevent fraud-induced transfer
- Telemarketing Sales Rule
  - Prohibits knowingly providing substantial assistance to a violation
  - Violations result in civil penalties (>\$50k per violation)

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## LEGAL REQUIREMENTS

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## CIP & Beneficial Ownership Requirements

- A BSA/AML compliance program must include:
  - a customer identification program (CIP) with risk-based procedures that enable the bank to form a reasonable belief that it knows the true identity of its customers;
  - appropriate risk-based procedures for conducting ongoing customer due diligence (CDD);
  - and complying with beneficial ownership requirements for legal entity customers as set forth in regulations issued by Financial Crimes Enforcement Network (FinCEN)

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## CIP

- The CIP must contain procedures for opening an account that specify the identifying information that will be obtained from each customer. The bank must obtain, at a minimum, the following information from the customer prior to opening an account:
  - Name
  - Date of birth, for an individual
  - Address
  - Identification number
- In connection with a customer who opens a credit card account, a bank may obtain the identifying information about a customer by acquiring it from a third-party source prior to extending credit to the customer.

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## CIP Continued

- The CIP must contain procedures for verifying the identity of the customer within a reasonable time after the account is opened.
- The procedures must describe when the bank will use documents, non-documentary methods, or a combination of both methods.

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## Beneficial Ownership Requirements

- Beneficial ownership is determined under both a control prong and an ownership prong.
- Control prong:
  - The beneficial owner is a single individual with significant responsibility to control, manage or direct a legal entity customer.
  - One beneficial owner must be identified under the control prong for each legal entity customer.
- Ownership prong:
  - A beneficial owner is each individual, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of a legal entity customer.
  - Identification of a beneficial owner under the ownership prong is not required if no individual owns 25 percent or more of a legal entity customer.
- Therefore, all legal entity customers will have a total of between one and five beneficial owner(s)—one individual under the control prong and zero to four individuals under the ownership prong.

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## FFIEC Guidance – Risk Factors for Lenders

- The involvement of multiple parties may increase the risk of money laundering or terrorist financing when the source and use of the funds aren't transparent. Lack of transparency can create opportunities of money laundering or terrorist financing schemes.
- These schemes could include the following:
  - To secure a loan, an individual purchases a certificate of deposit with illicit funds.
  - Loans are made for an ambiguous or illegitimate purpose.
  - Loans are made for, or are paid for, a third party.
  - The bank or the customer attempts to sever the paper trail between the borrower and the illicit funds.
  - Loans are extended to persons located outside the US, particularly to those in higher-risk jurisdictions and geographic locations. Loans may also involve collateral located outside the US.

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## FinCEN Guidance on Promoting a Culture of Compliance

- A financial institution with a poor culture of compliance is likely to have shortcomings in its BSA/AML program. A financial institution can strengthen its BSA/AML compliance culture by ensuring that:
  - leadership actively supports and understands compliance efforts;
  - efforts to manage and mitigate BSA/AML deficiencies and risks are not compromised by revenue interests;
  - relevant information from the various departments within is shared with compliance staff to further BSA/AML efforts;
  - institution devotes adequate resources to its compliance function;
  - the compliance program is effective by, among other things,
  - ensuring that it is tested by an independent and competent party; and
  - leadership and staff understand the purpose of its BSA/AML efforts and how its reporting is used.

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## FFIEC Guidance: Customer Due Diligence

- The cornerstone of a strong BSA/AML compliance program is the adoption and implementation of risk-based CDD policies, procedures, and processes for all customers, particularly those that present a higher risk for money laundering and terrorist financing.
- The objective of CDD is to enable the bank to understand the nature and purpose of customer relationships, which “may” include understanding the types of transactions in which a customer is likely to engage.
- These processes assist the bank in determining when transactions are potentially suspicious.

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## FFIEC Guidance: Customer Due Diligence Cont'd

- At a minimum, the bank must establish risk-based CDD procedures that:
  - Enable the bank to understand the nature and purpose of the customer relationship in order to develop a customer risk profile.
  - Enable the bank to conduct ongoing monitoring for the purpose of identifying and reporting suspicious transactions and, on a risk basis, to maintain and update customer information, including information regarding the beneficial owner(s) of legal entity customers.

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## FFIEC Guidance: Customer Due Diligence Cont'd

- In addition, the bank's risk-based CDD policies, procedures, and processes should:
  - Be commensurate with the bank's risk profile, with increased focus on higher risk customers.
  - Contain a clear statement of management and staff responsibilities, including: procedures, authority, and responsibility for reviewing and approving changes to a customer's risk profile, as applicable.
  - Provide standards for conducting and documenting analysis associated with the due diligence process, including guidance for resolving issues when insufficient or inaccurate information is obtained.

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## FFIEC BSA/AML Guidance: Identification of Specific Categories

- The first step of the risk assessment process is to identify the specific products services, customers, entities, and geographic locations unique to the company.
- Certain products, services, customers, entities, and geographic locations may be more vulnerable or have been historically abused by money launderers and criminals.
- Depending on the specific characteristics of the particular product, service, or customer, the risks are not always the same.
- Various factors, such as the number and volume of transactions, geographic locations, and nature of the customer relationships, should be considered when the company prepares its risk assessment.
- In reviewing the company's risk assessment, examiners determine whether management has developed an accurate risk assessment that identifies the significant risks to the company.

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## Corporate Transparency Act

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### Corporate Transparency Act (“CTA”)

- On January 1, 2021, Congress passed the CTA
- Empowers FinCEN to create and manage a national registry of beneficial ownership information.
- Legislation seeks to strengthen U.S. anti-money laundering regulations and prevent criminals and terrorists from funneling money through anonymous shell companies and other illegal tax vehicles.
- Every corporation, LLC, or other entity created by the filing of a document with a Secretary of State or similar office under the law of a state or Indian tribe is required to file a Beneficial Ownership Information (“BOI”) report unless it qualifies for an exemption.
- The initial BOI report and all updates and corrections will be filed electronically with FinCEN through a system that will be available via FinCEN’s website. There is no fee for filing the reports.

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## CTA Exemptions

- 23 categories of entities that are exempt
- Most exemptions are for entities that are already subject to substantial federal or state regulation.
  - publicly traded companies and other entities that file reports with the SEC, banks, credit unions, money services businesses, securities brokers and dealers, tax-exempt entities, insurance companies, state-licensed insurance producers, pooled investment vehicles, public utilities, and accounting firms.
  - A “large operating company” is an entity that (1) employs more than 20 full-time employees in the United States, (2) has an operating presence at a physical office within the United States, and (3) has filed a federal income tax or information return in the United States for the previous year demonstrating more than \$5 million in gross receipts or sales.

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## BOI Reports

- A domestic reporting company created before January 1, 2024 has to provide information about the company and about its beneficial owners.
  - A domestic reporting company created on or after January 1, 2024 has to provide information about the company, its beneficial owners, and its company applicants.
- **Company Information**
    - The report must set forth the reporting company’s (1) full legal name, (2) any trade or “doing business as” names, (3) complete current street address of the principal place of business, (4) jurisdiction of formation, and (5) taxpayer identification number.

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## BOI Reports Continued

- **Beneficial Owners and Company Applicant Information**

- **The report must set forth their:**

- (1) full legal name,
- (2) date of birth,
- (3) complete current residential street address (except in the case of a company applicant who forms or registers an entity in the course of the company applicant's business, who has to provide the street address of the business),
- (4) unique identifying number and the issuing jurisdiction from either a current (i) U.S. passport, (ii) state or local ID document, (iii) driver's license, or (iv) if the individual has none of those, a foreign passport, and
- (5) an image of the document from which the unique identifying number was obtained.
- A beneficial owner is an individual who, directly or indirectly, either exercises substantial control over the reporting company or owns or controls at least 25 percent of its ownership interests.
- A company applicant is the individual who directly files the document that creates the domestic reporting company and the individual who is primarily responsible for directing or controlling the filing if more than one individual is involved in the filing of the document.

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## BOI Reports Continued

- A domestic reporting company created before January 1, 2024, must file its initial BOI report not later than January 1, 2025.
- A domestic reporting company created on or after January 1, 2024, must file a report within 30 calendar days of the date on which it receives actual or public notice that its creation has become effective.
- If there is any change in the information reported about the reporting company or its beneficial owners, the reporting company must file an updated report within 30 calendar days after the date on which the change occurs. This includes a change in who the beneficial owners are and if the reporting company becomes eligible for an exemption.
- There is no requirement for a reporting company to update information about the company applicants become effective.

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## Preparation

- Determine whether you are required to file a BOI report
- If so, determine the information required for your BOI report
  - Confirm it's up to date before filing!
- Procedure to track when you need to update information with FinCEN
- More information may be found here: <https://www.fincen.gov/boi>

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**Questions?**

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