

New Customer Identification Program (CIP) Requirements for Broker/Dealers

Supervisory Considerations for Implementing the Joint Final Rule Requirements under Section 326 of the USA PATRIOT Act

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By Scott P. Tarra
starra@financiareg.com

Summary

Effective October 1, 2003, broker/dealers¹ and other "financial institutions"² are required to comply with the joint final rule on Section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act). The Department of the Treasury, through the Financial Crimes Enforcement Network (FinCEN), and the Securities and Exchange Commission (SEC) are jointly adopting the final rule to Section 326 which will require, at a minimum, broker/dealers to implement procedures to (i) verify the identity of any person seeking to open an account, to the extent reasonable and practicable; (ii) to maintain records of the information used to verify the person's identity; and (iii) to determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to broker/dealers by any government agency.

Key Definitions

In order to further understand the new CIP requirements, broker/dealers must first gain a clear understanding of some of the key operational definitions that are critical in the

context of the joint final rule. Some of the important key terms that are highlighted in the Rule are the specific definitions of an account, customer and a U.S. person.

Account- the definition of an "account" is any formal business relationship with a broker/dealer established to effect financial transactions in securities, including, but not limited to, the purchase or sale of securities, securities loan and borrowed activity or the holding of securities or other assets for safekeeping or as collateral. However, certain exclusions from this definition include certain transfers of accounts from one broker/dealer to another as in the case of an acquisition, merger, purchase of assets, or assumption of liabilities, or certain accounts opened for the purpose of participating in an employee benefit plan established pursuant to the Employee Retirement Income Security Act of 1974.³

Customer- the term "customer" is defined as any person that opens a new account⁴ except in the case of minors and non-legal entities. However, this definition does not refer to persons who fill out the account opening paperwork or provide information necessary to set up an account, if such persons are not the accountholder as well.

¹ The term "broker-dealer" is defined as any person registered or required to be registered with the Commission, except persons who register solely to effect transactions in securities futures products (NPRM, 67 FR at 48317).

² This term includes commercial banks, agencies and branches of foreign banks in the United States, thrifts, credit unions, private banks, trust companies, investment companies, futures commission merchants, insurance companies among many others.

³ 31 CFR 103.122 (a)(1)(ii)(B).

⁴ 31 CFR 103.122 (a)(4)(i)(A).

Therefore, broker/dealers are required only to verify the identity of the named accountholder(s), and are generally not required to look through a trust, an omnibus account established by an intermediary, or other similar account to its beneficiaries.

Exceptions to this definition may apply for persons who have an existing account with the broker/dealer, provided that it has a reasonable belief that it knows the true identity of the person, and readily identifiable entities, including: (1) financial institutions regulated by a federal functional regulator; (2) banks regulated by a state bank regulator; and (3) persons described in section 103.22(d)(2)(ii)-(iv) of the BSA regulations, such as governmental agencies and instrumentalities and companies that are publicly traded.

U.S. Person/ Non-U.S. Person- The term "U.S. person" is defined as any individual who is a U.S. citizen, or an entity established or organized under the laws of a State or the United States.

Minimum CIP Requirements

In accordance with the requirements of Section 326, broker/dealers are required to establish, document, and maintain a written CIP as part of their overall anti-money laundering (AML) program. The implementation of the CIP procedures must enable a broker/dealer to form a reasonable belief that it knows the true identity of its customer(s).⁵

The CIP procedures are generally based on an overall assessment of relevant risk factors which include the type of identifying information available to a broker/dealer, its size, scope and operational function, as well as its reliance on another broker/dealer. Additionally, broker/dealers should consider a consistent and ongoing evaluation of its existing customer identification methods, and whether such methods are appropriate and effective under the current structure.

Customer Identity Verification Procedures

A broker/dealer's CIP should include specific procedures for verifying the identity of its customers, to the extent reasonable and practicable⁶, and a description of the firm's use of documentary and non-documentary methods, or a combination of both in the customer identification and verification process. The procedures should further detail all relevant risks associated with the various types of accounts a broker/dealer may encounter, as well as the overall size, scope and operational function of the firm. The verification of such information should occur within a reasonable time from the opening or approval of the customer's account. The ultimate goal of the identity verification procedures is for a broker/dealer to form a reasonable belief that it knows the true identity of its customers.

Required Customer Information

At a minimum, broker/dealers are required to obtain certain identifying information about its customers to include the following:

- Name;
- Date of birth (for an individual);
- Address Information (for an individual, residential or business address information would be acceptable; for an individual without a residential or business street address, an Army Post Office or Fleet Post Office box number, or the residential or business street address of a next of kin or another contact individual; for a person other than an individual such as a corporation, partnership or trust, a principal place of business, local office or other physical location); and
- Identification number (For a *U.S. person*, a taxpayer identification number such as a social security number or an employer identification number; or for a *non-U.S. person*, one or more of the following: a taxpayer identification number, a passport number and country of issuance, an alien identification card number, or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard).

⁵ NPRM, 67 FR at 48317.

⁶ 31 CFR Part 103.122 (b)(2).

In the event that a customer has applied for, but has not received, a taxpayer identification number, the broker/dealer may still open an account for such person(s) under certain circumstances. For example, the broker/dealer should request a copy of any corresponding documentation to confirm that the application was filed before the customer opened an account, and obtain the taxpayer identification number within a reasonable period of time after the account is opened (approx. 5 days). When opening an account for a foreign business or enterprise that does not have an identification number, the broker/dealer should request an alternative government-issued document certifying the existence of the business or enterprise.

Customer Verification Methods

As previously stated, the verification of customer identification should occur within a reasonable time period from the opening or approval of the customer's account. The amount of time may depend on several factors, such as the type of account, the method of opening the account, and the type of identifying information available at the time of account opening.

To the extent reasonable and practicable, each broker/dealer should ensure that it has a reasonable belief that it knows the true identity of its customers by using risk-based procedures to verify and document the accuracy of the information it receives about its customers. Broker/dealers should further verify customer identity through the review of documentary evidence, non-documentary evidence or a combination of both methods, and under what types of circumstances such methods will be used.

Documentary Methods of Verification

Each broker/dealer firm should implement its own risk-based analysis of the types of documents that it believes will enable it to verify the true identities of its customers. Examples of documents that a broker/dealer may use in the verification process may include the following:

- for natural persons, an un-expired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and/or
- for persons other than an individual (such as a corporation, partnership, or trust), one or more documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or a trust instrument.

Validity of Documentation

In determining the validity of customer identification, the Rule further clarifies that once a broker/dealer obtains and verifies the identity of a customer through a particular document, such as a driver's license or passport, the firm is *not* required to determine its validity. Therefore, a broker/dealer may rely on government issued identification as verification of a customer's identity, unless there are "obvious indications of fraud."⁷ Although this position may appear to increase a firm's exposure to potential fraud, broker/dealers are strongly encouraged to employ many different customer identification methods whereby the totality of procedures should represent sufficient safeguards to reduce incidents of fraud.

Non-Documentary Methods of Verification

Under certain circumstances, a broker/dealer firm may not rely on documentary methods for verifying a customer's identity. In these cases, a broker/dealer should describe all relevant non-documentary methods to be used to verify customers' identities, and under what circumstances a firm may implement these methods in addition to, or instead of, relying on customary documentary methods of verification. Examples of non-documentary methods that a broker/dealer may use in the verification process may include the following:

- Contacting the customer;
- Independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a customer

⁷ 31 CFR Part 103.122(b)(2)(ii)(A)

reporting agency, public database, or other relevant source;

- Checking references with other financial institutions; and/or
- Obtaining a financial statement.

The Rule further states that broker/dealers should develop clear policies and procedures that detail the circumstances under which a firm may implement non-documentary methods of verification. Examples of circumstances which may prompt a firm to utilize such methods may include one or more of the following:

- When an individual is unable to present an unexpired government-issued identification document that bears a photograph or other similar safeguard;
- When a broker/dealer is not familiar with the documents currently presented;
- When the account is opened without obtaining documents as specified under documentary methods;
- When the customer opens an account without appearing in person;
- When a broker/dealer is unable to verify the true identity of a customer through documentary methods; or
- When a broker/dealer is presented with identification documents that may appear questionable, suspicious or otherwise invalid.

Additional or Enhanced Verification Procedures

Although broker/dealers may be able to adequately verify the majority of customers through documentary and/or non-documentary methods, there may be certain instances where such methods may be inadequate or insufficient. As a result, broker/dealers may choose to prescribe additional verification procedures for certain accounts that may be associated with heightened risk (e.g. accounts opened in the name of a corporation, partnership or trust that are created or conduct substantial business in jurisdictions that have

been designated as a primary money laundering concern or as a non-cooperative by an international body).

Lack of Verification

The Rule further clarifies that broker/dealers should have adequate procedures in place to determine the type of action taken in the event that it cannot form a reasonable belief that it knows the true identity of a particular customer. In cases where the true identity of a customer cannot be known, broker/dealers should avoid opening an account for such person, or avoid conducting transactions while attempting to verify the true identity of the person.

Record Keeping Requirements

In accordance with the recordkeeping requirements of Section 326, broker/dealers must continue to create and maintain specific records of the identifying information obtained about each customer.⁸ However, instead of requiring that broker/dealers maintain copies of verification documents, broker/dealers must now maintain records which include a *description* of any document that it relied on as verification of a customer's identity, to include the type of document, any corresponding identification number contained in the document, the place of issuance, and any issuance and expiration dates that may apply. For any non-documentary methods of verification, broker/dealers are required to include a *description* of the methods employed as well as any corresponding results from the identity verification process. Additionally, in the event of any substantive discrepancy involving the verification of a customer's identity, broker/dealers are required record the resolution of such issues as discovered during the identity verification process.⁹

Record Retention Requirements

Broker/dealers are required to maintain records and other pertinent documentation relating to its anti-money laundering program for a period of five (5) years. More specifically, all relevant identification information obtained from the customer shall be retained for a period of five years after the date the account is closed.

⁸ 31 CFR 103.122(b)(3)(i)(A).

⁹ 31 CFR 103.122(b)(3)(i)(D).

Those records that verify a customer's identity will be maintained for a period of five years from the date the record is made.

Comparison with Government Lists

The Rule requires that broker/dealers should consistently review its customers to determine whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators.¹⁰ Such a determination shall be made within a reasonable period of time after the account is opened, or earlier if required by another Federal law or regulation or Federal directive issued in connection with the applicable list, and each broker/dealer shall follow all Federal directives issued in connection with such lists. However, at this time, the Treasury and the Federal functional regulators have not yet designated any single government lists.

Customer Notification

In accordance with the Rule, broker/dealers should provide its customers with adequate notice that it is requesting information to verify their identities. The notice will briefly describe the identification requirements in a manner that is reasonably designed to ensure that a customer is able to view the notice, or is otherwise given notice, before the opening of an account. For example, depending upon the manner in which the account is opened, broker/dealer may have the option of posting a notice in its office or on its website, include the notice on its account applications or use any other form of oral or written notice.

The notification may read as follows:

"IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT. To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account. What this means for you:

When you open an account, we will ask for your name, address, date of birth and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents."

Reliance on another Financial Institution

Under certain circumstances, a broker/dealer may reasonably rely on the performance of another financial institution's CIP (including an affiliate) with respect to any of its customers that is opening an account or has established an account or similar business relationship with another financial institution to provide or engage in services, dealings, or other financial transactions, provided that:

- Such reliance is reasonable under the circumstances;
- The other financial institution is also subject to anti-money laundering requirements of 31 U.S.C. 5318(h) and regulated by a "Federally functional regulator;" and
- The other financial institution enters into a contract requiring it to certify annually to the Firm that it has implemented its anti-money laundering program, and that it will perform specified requirements of the broker/dealer's CIP.

Mr. Tarra is a Managing Principal of Financial Registrations, Inc., a compliance management consulting firm providing registration and compliance advisory services to securities broker/dealer and registered investment advisers. For more information on this topic or other compliance related matters, please contact:

Scott P. Tarra
Managing Principal
starra@financialreg.com

Financial Registrations, Inc.
25602 Alicia Parkway #107
Laguna Hills, CA 92653
www.financialregistrations.com

Toll-free (800) 641-1818
Direct (949) 770-6154
Fax (949) 770-6198

¹⁰ 31 CFR 103.122(b)(4).