SOUTH DAKOTA
Division of Banking

1601 N. Harrison Ave, Suite 1
Pierre, SD 57501
Phone (605) 773-3421
Fax (866) 326-7504

Foreign Trust Acceptance and Oversight Guidance

Prior to accepting trusts created by and/or for the benefit of foreign nationals, or trusts that hold foreign assets, management must perform and document a thorough review to identify the purpose of the trust, the identity of the customer, and the source of the underlying funds. If management is uncertain about the character of a trust's assets, the U.S. Department of the Treasury (Treasury Department) instructions for Form 8938 provides a description of foreign assets. While there are legitimate reasons for the movement of foreign trusts and assets to and from domestic financial institutions, there is also a risk that these types of trusts are created to conceal the sources and uses of funds, the identity of beneficial and legal owners, or to avoid foreign reporting requirements. Furthermore, trust customers and beneficiaries may try to remain anonymous to move illicit funds or avoid scrutiny or may seek a certain level of anonymity by creating offshore accounts, or other investment entities, that hide the true ownership or beneficial interest of the trust. Therefore, the financial institution must develop pre- and post-acceptance review processes that identify the risk profile of each foreign trust and develop and implement a corresponding initial and ongoing due diligence review program that is commensurate with the level of risk each trust poses. First and foremost, written policies and procedures must be drafted to provide management with comprehensive customer identification and oversight guidance.

Foreign Customer Identification

As with customer identification requirements for domestic customers, financial institutions must collect the name, date of birth, address, and identification number for non-U.S. persons. An identification number for a non-U.S. person is one or more of the following: a taxpayer identification number; a passport number and issuing country; an alien identification card number; or any other unexpired government-issued document evidencing an identification number, nationality or residence, and bearing a photograph or similar safeguard. Additionally, an effective customer identification program (CIP) should provide procedures to evaluate the risk of potential customers.

For purposes of the CIP, financial institutions are not required to search the trust, escrow, or similar accounts to verify the identities of beneficiaries, but instead are required to verify the identity of the customer, which is typically an individual, trust, or a legal entity. With respect to trusts created for the benefit of foreign nationals and their extended families, financial institutions are required to perform enhanced due diligence to identify the customer and source of funds. If the customer is identified as a trust or other legal entity, additional due diligence may be required to identify the beneficial owner(s).

If a trust is identified as the customer, the beneficial owner is the trustee(s) or any other person, such as a grantor or protector, who, in accordance with provisions of the governing document, has effective control of the trust or trust property or has the power to amend the trust or remove/appoint trustees.

If a legal entity is identified as the customer (i.e. a non-U.S. corporation, or, in the case of a trust, if a legal entity created the trust), the financial institution is required to identify the beneficial owner of the entity. A legal entity customer is defined to include the following types of entities: corporations, limited liability companies, general partnerships, limited partnerships, business trusts, other entities created by the filing of a public document with a secretary of state or similar office, or similar entities formed under the laws of a non-

U.S. jurisdiction. Beneficial owner is defined as an individual who owns 25 percent or more of the equity interests of the legal entity customer; a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer or senior manager (e.g. chief executive officer, chief financial officer, chief operating officer, managing member, general partner, president, vice president, or treasurer); or any other individual who regularly performs similar functions (this list of positions is illustrative, not exclusive, as there is significant diversity in how legal entities are structured). Financial institutions can develop internal forms or checklists to document the beneficial owner(s) of legal entity customers or obtain a fillable and non-fillable copy of an optional Certification Regarding Beneficial Owners of Legal Entity Customers available on the Financial Crimes Enforcement Network (FinCEN) website.

If a trust owns directly or indirectly, through any contractual arrangement, understanding, relationship, or otherwise, 25 percent or more of the equity interest of a legal entity customer, the beneficial owner is the trustee(s) or any other individual, such as a grantor or protector, who in accordance with provisions of the trust document has effective control of the trust or trust property, or has the power to amend the trust or remove/appoint trustees. With respect to a directed trust, where the trustee is directed by a trust advisor pursuant to South Dakota Codified Laws Chapter 55-1B, the directed trustee may not be required to inquire into the other ownership interest in said legal entity if the legal entity itself is not the customer.

While the financial institution is required to identify and document the beneficial owner of the customer, the information collected and maintained by the financial institution about the beneficial owner(s) is subject to the confidentiality requirements of law owed by the financial institution towards its customers. To that end, when a financial institution enters banking or investment relationships with third party banks, investment advisors, or asset custodians (Third Parties) through omnibus accounts or otherwise that are in the name of the financial institution, the information that is disclosed to Third Parties is the information about the financial institution itself, and not that of its customers, or their beneficial owners. In this circumstance, disclosure of customer or beneficial owner information by the financial institution may be imprudent.

<u>Customer Risk Rating</u>

Financial institutions should develop a risk-based approach to determine if the foreign trust has a risk profile of low, medium, or high. It is anticipated that most foreign trusts will have a risk profile of medium or high, which will require the development and implementation of an enhanced due diligence review process outlined below. A conclusion regarding the customer risk profile should be based on an evaluation of all pertinent information including but not limited to the purpose of the trust, identity of the customer and its beneficial owner(s), geographical and political characteristics, anticipated account activity, and source of funds. This information, commonly referred to as a customer risk profile, should aid the financial institution in determining the money laundering and terrorist financing risks of its customers. Regulatory guidance acknowledges a spectrum of risks may be identifiable even within the same category of customers, and the assessment of customer risk factors is institution-specific. Given the complexities of foreign trusts, decisions to rate these customers into a risk category that falls outside of the enhanced due diligence review process of the institution should not be commonplace, and any such determination should be well documented.

<u>Enhanced Due Diligence Review Criteria</u>

In addition to standard CIP requirements for domestic individuals, trusts categorized with risk profiles of medium or high will require the review of additional criteria to document the identity, business activity, ownership structure, anticipated or actual volume and types of transactions of a foreign customer and/or domestic customer with foreign beneficial owners, particularly including those transactions involving higher risk jurisdictions. At acceptance, the following information should be gathered on the foreign customer or beneficial owner:

- Background investigations. Obtain and document a worldwide independent background investigation by an authorized organization (e.g., Refinitiv [formerly Thomson Reuters] World-Check, LexisNexis InstantID International, etc.) on all customers and beneficial owners or document an equivalent background investigation. An equivalent background investigation may be appropriate where the customer or beneficial owner is a public company or a prominent family whose activities are well reported.
- Purpose of the trust. Identify and document the legitimate reason for creating the trust or for transferring the trust from a foreign jurisdiction.
- Proof of compliance with foreign jurisdiction taxation requirements. A sworn statement from the customer or beneficial owner or the customer's or beneficial owner's trustee(s), lawyer(s), wealth manager(s), accountant(s), or banker(s) affirming tax compliance will generally suffice.
- Source of funds. Generally, wealth is derived from inheritance, active business enterprises, former business enterprises, or professional income. Document the source of funds being deposited into the trust. A sworn statement from the customer or beneficial owner or the customer's or beneficial owner's trustee(s), lawyer(s), wealth manager(s), accountant(s), or banker(s) detailing the source of funds may suffice but is not required if the source of funds can be documented from other sources.
- Proof of residence. If the customer or beneficial owner is an individual, obtain invoices that identify the customer's street address, city, and state/country which generally consist of billings for utilities, phone, repair work, television, wireless connectivity, etc.
- Occupation or type of business of the customers and beneficial owners.
- High Risk Only – If the customer or beneficial owner is engaged in business, obtain a description of the primary trade area and whether international transactions are expected to be routine.
- High Risk Only – Determine the expected frequency (weekly/monthly/annually), number, and expected value of transactions that will flow through the trust.

<u>Ongoing Due Diligence Regarding Customer Identification</u>

Customer identification is an ongoing process. The financial institution should establish a risk-based monitoring system to ensure customer profiles are periodically updated. The monitoring system should review and assess each trust's risk profile and update as needed. Best business practices dictate that ongoing due diligence should occur at least annually for trusts that have high risk profiles, at least once every two years for trusts that have medium risk profiles, and at least once every three years for trusts that have low risk profiles. Management must develop, implement, and document a comprehensive ongoing due diligence review process that at minimum encompasses the following criteria:

- Review and assess annually the financial institution's CIP risk assessment (i.e. the likelihood the trusts could be used for money laundering or to finance terrorism); this function can be performed separate from the account-level review process (i.e. internal/external audits, independent assessments, etc.).
- Review trust opening documentation, including the enhanced CIP, to ensure that adequate due diligence has been performed and that appropriate records are maintained.
- Identify any unusual or suspicious activity, ensuring the timely filing of suspicious activity reports.

- Conduct periodic FinCEN searches of the customers and beneficial owners on all trusts.
- Conduct periodic checks of the customers and beneficial owners on all trusts against the Specially Designated Nationals list of the Office of Foreign Assets Control of the Treasury Department.
- Conduct periodic reviews of the beneficial owners of the legal entity and the individual with responsibility to control the legal entity.
- High Risk Only - Conduct an internet search of the customers and beneficial owners.
- High Risk Only - Review account statements and, as necessary, specific transaction details. Compare expected transactions with actual activity.
- High Risk Only - Determine whether actual activity is consistent with the nature of the customer's or beneficial owner's business and the stated purpose of the trust.
- High Risk Only - Require explanations for changes in trust activity. For directed trusts, a letter from the trust advisor with the direction may satisfy this requirement.

The ongoing due diligence can be a function of the trust company's internal audit program or a function of personnel/committees appointed by management.