BANK POLICY INSTITUTE

Implementing the Corporate Transparency Act

Angelena Bradfield | July 22, 2021

This blog post was originally published by Ballard Spahr LLP as part of their *Money Laundering Watch* series*. The post features a questions and answers style commentary from Angelena Bradfield, BPI senior vice president of AML/BSA, sanctions and privacy, regarding the Corporate Transparency Act (CTA), which passed on January 1, 2021. To learn more about BPI's work on this issue, please click here. To access the original post, please click here.*

Today we are very pleased to welcome guest blogger Angelena Bradfield, who is the Senior Vice President of AML/BSA, Sanctions & Privacy for the Bank Policy Institute. BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks. Its members include universal banks, regional banks and the major foreign banks doing business in the United States. BPI has been engaged in efforts to modernize the U.S. anti-money laundering/countering the financing of terrorism (AML/CFT) regime for almost half a decade and worked closely with Senate and House leadership throughout the introduction and final passage of the Anti-Money Laundering Act of 2020 (AML Act). Angelena previously was a Vice President at The Clearing House Association, where she supported its regulatory affairs department in similar policy areas. Before that, she supported comprehensive immigration reform efforts at ImmigrationWorks USA and worked on various domestic policy issues at the White House where she served as a staff assistant in both the Domestic Policy Council and Presidential Correspondence offices.

We reached out to Angelena regarding BPI's recent letter to the Financial Crimes Enforcement Network (FinCEN) commenting on its implementation of the Corporate Transparency Act (CTA). Congress passed the CTA on January 1, 2021, as part of the AML Act. The CTA requires certain legal entities to report their beneficial owners to a directory accessible by U.S. and foreign law enforcement and regulators. This directory also will be accessible to U.S. financial institutions seeking to comply with their own AML obligations, particularly the beneficial ownership regulation, otherwise known as the Customer Due Diligence Rule (CDD Rule), already applicable to banks and other financial institutions. The CTA's beneficial ownership directory is one of the most important and long-awaited changes to the BSA/AML regulatory regime, but it presents many challenges, both legal and logistical. On April 5, 2021, FinCEN issued an advance notice of proposed rulemaking to solicit public comment on the CTA's implementation. In response, FinCEN received over 200 letters from industry stakeholders – including the letter from BPI.

This blog post again takes the form of a Q&A session, in which Angelena responds to questions posed by *Money Laundering Watch* about the CTA and how it should be implemented. We hope you enjoy this discussion on this important topic. – Peter Hardy and Shauna Pierson

Some people in Congress and law enforcement pushed for the passage of the CTA by claiming in part that the CTA would be a good thing for financial institutions, including banks. Is it?

Absolutely. The CTA closes a gap in the U.S. incorporation system exploited for decades by human traffickers, money launders, terrorist financiers and other illicit actors. That is a positive thing for all law-abiding citizens and especially the U.S. financial system. It also directs FinCEN to streamline the collection and retention of beneficial ownership information by having it go directly to the government and directing FinCEN to update the CDD rule to reduce "unnecessary or duplicative" burdens on financial institutions which drains resources that could be better used to

detect criminals. However, as FinCEN is in the early stages of the various rulemakings required under the CTA, there is still a lot of work to be done to facilitate a sensible rollout of these requirements so that the directory can be highly useful to law enforcement, intelligence, national security agencies and federal functional regulators as set forth in the statute.

When FinCEN promulgates the regulations implementing the CTA, what are the most important things that FinCEN needs to do from your perspective? What should it not do?

FinCEN should implement the CTA in a manner that would enable the CDD rule and related know-your-customer requirements, like the Customer Identification Program (CIP) rule, to be harmonized with the CTA. Aligning these expectations with the law will limit implementation and reporting complexities for covered legal entities. In addition, it will allow financial institutions to leverage the FinCEN directory, as needed and with customer consent, for relevant customer identification requirements. Today, there are many discrepancies between the requirements set forth in the CTA and the CDD rule, including the scope of covered entities which we can discuss further. There is also a material discrepancy between customer information required under know-your-customer regulations and the CTA — banks collect customer and beneficial owner social security numbers under CIP and CDD rules, but this is not required identifying information under the CTA. Harmonizing CIP and CDD expectations with the statutory standard set forth in the CTA will create a clear, coherent framework for mitigating relevant illicit finance risks and prevent financial institutions and reporting companies from facing unnecessary and duplicative burdens that can distract them from detecting and preventing criminal activity.

Furthermore, in the space between regulatory requirements and implementation, it is essential that FinCEN verify the information in the directory so that it is reliable for both law enforcement and financial institutions. This is a significant issue that beneficial ownership registries in other countries have encountered and should be thoughtfully addressed at the outset to ensure that the data housed in the directory is highly useful to law enforcement and other government entities.

Ultimately, the FinCEN directory should provide a centralized source of beneficial ownership information about reporting companies. Therefore, financial institutions should not be subject to a duplicative requirement to separately collect and verify beneficial ownership information from all customers. In the experience of BPI members, beneficial ownership information has not generated significant suspicious activity reporting or law enforcement inquiries. However, banks should be permitted, but not required, to rely on the information in the directory to satisfy any CDD rule obligations, which would be consistent with the creation of the directory as a centralized source of information about the beneficial owners of those legal entities for which Congress determined it was necessary to require such information.

But FinCEN is used to others – specifically, financial institutions – verifying information, which FinCEN and other regulators or law enforcement then receive or access. Is FinCEN really going to have the tools, capacity, and/or interest in verifying the directory?

Yes, verification of reported beneficial owners could be completed by FinCEN using automated non-documentary tools, with human intervention limited to addressing material inconsistencies that result from non-documentary verification. FinCEN could use similar commercial tools to those already used by individual financial institutions to verify the identity of beneficial owners. It could also consider leveraging application programming interfaces to link with systems or directories maintained by other federal agencies, secretaries of state, or similar offices. In addition, FinCEN could also require or request that reporting companies and their beneficial owners provide a copy of an acceptable identification document as defined in the CTA.

FinCEN should have a strong interest in verifying the information in the directory. If the information is not verified, users of the directory will have little reason to trust or rely on it, which does not advance the stated purpose of the

CTA, which is to collect beneficial ownership information, as discussed earlier, "in a form and manner reasonably designed to generate a database that is highly useful to national security, intelligence, and law enforcement agencies and federal functional regulators."

The Letter anticipates the possibility of discrepancies in the directory vs. a financial institution's own information regarding the same entity. The Letter states: "We expect that such discrepancies will be pervasive, which we understand has been the case in other jurisdictions that have implemented beneficial ownership registries." What are these other jurisdictions, and how have they tried to solve such discrepancies? What should be done here in the U.S.?

As the first open beneficial ownership register, the UK's Companies House is perhaps the best case study for illustrating the potential for discrepancies. While the Companies House registry has key differences from the directory required by the CTA, as discussed in a February 2021 House of Commons Library Briefing Paper, "[o]ne of the criticisms of the register stems from the fact that the information submitted by companies is not verified. Companies House is a *registrar*, not a regulator. By and large, it does not verify the accuracy of what it receives." Therefore, there are numerous discrepancies, with financial institutions and other entities required to report on them. The Briefing Paper points out that a 2019 governmental *Review of the Implementation of the PSC Register* found that "many stakeholders suggested that Companies House introduce both validation (e.g. checks at the point information is submitted) and verification processes (e.g. checks to verify the information submitted). Stakeholders felt that the combination of these two processes would significantly improve the quality of the information held on the PSC register and so make the register more useful." A September 2020 governmental response to this consultation stated that, among other things, "[t]he Government will introduce compulsory identity verification for all directors and People with Significant Control (PSC) of UK registered companies…"

From a U.S. perspective, we can leverage the UK's experience to improve the utility of the FinCEN directory at the outset by introducing verification mechanisms to help address discrepancies as previously described. However, financial institutions should not be required to separately identify and verify beneficial owners as they would expend enormous resources resolving discrepancies identified between individually collected beneficial ownership information and the FinCEN directory. It would also be inconsistent with Congress's instruction, in the CTA, to amend the CDD rule to reduce burdens on financial institutions that are unnecessary or duplicative.

How are the CTA and the CDD Rule, already applicable to financial institutions, different? Can they be harmonized, and if so, how?

It is critical that FinCEN implement the CTA so that beneficial ownership requirements under the CDD rule and any future revisions are harmonized with the statute. A consistent, clear and coherent framework will better address relevant illicit finance risks and prevent financial institutions and reporting companies from facing unnecessary and duplicative burdens, in line with the statute's direction.

There are two material areas where FinCEN should harmonize the CDD rule with the CTA:

1) The definition of "legal entity customer" under the CDD rule should be aligned with the definition of "reporting company" under the CTA.

2) The different definitions of "beneficial owner" in the CDD rule and CTA should be aligned, with FinCEN providing additional clarity to facilitate a consistent application of this definition to an individual who "control[s]" a legal entity.

A lack of alignment between these standards would impose duplicative and unnecessary burdens on both institutions and their customers. Moreover, BPI believes that revising the CDD rule to align with the definitions in the CTA will not substantially affect illicit finance risks and

reflects Congress's view of the circumstances under which requiring the collection of beneficial ownership information best promotes, among other things, the mitigation of

illicit finance risks. In addition, and as previously discussed, BPI members indicate that beneficial ownership information has not generated significant Suspicious Activity Report (SAR) filings or law enforcement inquiries. Ultimately, the operational burden of dealing with inconsistent definitions appears unlikely to be outweighed by any associated benefits.

Finally, required updates to beneficial ownership information should be linked to processes under the CTA and not the CDD rule's expectation that such information is updated whenever a customer opens a new account. The CTA provides a roadmap for implementing a requirement to update information and FinCEN's proposal suggests that reporting companies could be required to affirmatively confirm, on a periodic basis, the continued accuracy of their previously reported beneficial ownership information. This suggests that new account openings should no longer serve as the trigger for identification and verification of beneficial owners as this would be unnecessarily duplicative and needlessly burdensome. Eliminating requirements tied to new account openings under the CDD rule would also, in line with the purposes of the AML Act, enable institutions to allocate BSA/AML program resources to more effective activities. The CDD rule's collection expectation at the opening of every new account is extremely burdensome, particularly for customers who open multiple accounts on the same day or within a few days. There is no reason to believe that opening a new account, in and of itself, is an indication of changed beneficial ownership information. BPI members also are not aware of any feedback from law enforcement that re-collection has made a difference in addressing illicit finance risks. FinCEN should instead leverage the CTA's provisions around updating reported information to ensure that information in the directory remains up to date.

The Letter states that financial institutions should be permitted, but not required, to rely on the directory. Why shouldn't financial institutions be required to use the directory as part of their own know-your-customer and customer due diligence obligations under the BSA? Wouldn't such a requirement strengthen AML compliance and improve the integrity of the directory?

As discussed earlier, there are significant differences between the CTA and the CDD rule that need to be harmonized in order to make the directory useful to financial institutions. Furthermore, verification of the information submitted to the directory is essential to ensuring that the information it contains is useful. These issues need to be addressed through the rulemaking process before financial institution expectations are revisited and determinations are made relating to CDD rule requirements. Ultimately, utilizing financial institutions to identify discrepancies would likely have a significant impact on resourcing and drive bank processes to administrative tasks, resulting in reporting that is not highly useful and unnecessary and duplicative burdens on financial institutions and reporting entities.

Instead, FinCEN should expressly permit financial institutions to rely on the information in the directory and provide a safe harbor for institutions that do so. Reliance by financial institutions for CDD rule obligations would be consistent with the creation of the directory as a centralized source of information about beneficial owners, allowing institutions to do any additional beneficial ownership information collection or verification, solely on the institution's assessment of the relevant risks, not pursuant to a regulatory mandate such as the CDD rule.

The Letter also asserts that FinCEN should broadly interpret what it means to be a "reporting company." Just how broadly, and why?

The CTA generally defines a "reporting company" as a corporation, limited liability company, or "other similar entity" that is created by filing a document with a secretary of state or a similar office under U.S. state or Indian Tribal (as defined in the CTA) law or formed under foreign law and registered to do business in the United States by filing with a secretary of state or similar office.

The inclusion of "other similar entity" recognizes that corporations and LLCs are not the only types of entities that generate illicit finance risks. This view is enhanced by two separate Congressional reports requiring the GAO to study whether any excluded entities raise illicit finance concerns. FinCEN should interpret this phrase to include *any* entity

that is, like a corporation or an LLC, registered to do business by filing a document with a secretary of state or similar office. By interpreting "other similar entity" broadly, the "reporting companies" required to report beneficial ownership information to FinCEN would include any statutory trusts, limited partnerships, general partnerships, and special purpose vehicles that are, as applicable, created or registered to do business by a filing of the type specified in the CTA. A narrow definition of "other similar entity" that excludes certain entity types from required beneficial ownership reporting would create a clear gap in the regime and may increase illicit finance risks. Further, any unnecessary burdens that arise from a broad construction of the entities subject to required beneficial ownership reporting under the CTA may be addressed through targeted exemptions as provided for in the statute.

Obviously the CTA is a federal law, and it requires reporting to the federal government. But it applies to entity formation at the State and tribal government level. What is the role of States and Tribes, if any, in a successful implementation of the CTA?

Both states and tribes will need to work closely with FinCEN to facilitate successful implementation of the CTA. The CTA creates various mechanisms to facilitate this exchange, notably by directing states and tribes, as a condition for funding, to notify filers of reporting expectations and provide relevant information about the requirement in incorporation materials and through other mechanisms.

Given the divergent incorporation standards across the states, significant collaboration will be required to implement a strong reporting system. Fortunately, FinCEN already has some allies in the states, notably over 40 attorneys general who expressed support for earlier versions of the AML Act's beneficial ownership reporting requirement. FinCEN will also need to engage with tribal governments to appropriately implement the CTA given the unique aspects of tribal-owned businesses – notably that formation documents can be substantially different from those of other legal entities and ultimate control may be retained by a tribal council, which delegates authority to businesses and individuals.

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