

FinCEN Proposes Regulations to Implement the BSA's Revised Legal Entity Requirements

by Joseph Lynyak and Erin Bryan

Pursuant to the adoption of comprehensive revisions to the U.S. anti-money laundering statutes as part of the Defense Appropriations Act of 2021 (the "Defense Act")¹, on December 8, 2021, the Financial Crimes Enforcement Network ("FinCEN") issued proposed regulations to implement revised beneficial ownership rules for legal entities (the "Proposal")². Specifically, the Proposal implements Section 6403 of the Corporate Transparency Act (the "CTA"), which requires specified reporting companies, including corporations, limited liability companies and similar entities, to submit to FinCEN specified information identifying their beneficial owners—that is, the individual natural persons who own or control them—as well as information about the persons—termed "company applicants"—who form or register those corporate entities.³

The Proposal is a major departure from the current scheme of FinCEN's Regulations regarding the identification of the beneficial ownership of legal entities, which currently merely requires banks, other lenders and certain other financial intermediaries (defined as "financial institutions") to obtain "beneficial ownership information" ("BOI") prior to engaging in a covered transaction or an account relationship with a legal entity. While these obligations will remain (or likely will be modified in regard to customer due diligence requirements ("CDD") in a rule-making to be issued by FinCEN later this year), the CTA creates a federal BOI data base that will receive information provided *directly* from reporting legal entities, and will make that information available to certain government agencies, as well as financial institutions that are currently subject to obtaining BOI pursuant to FinCEN's CDD regulation (the "CDD Rule")⁴.

Importantly, and discussed below, the scope of reportable information has been substantially expanded, and eventually will require literally millions of smaller-sized legal entities to initially register with FinCEN over the next several years—as well as each time a new reporting company is either formed or registered.

The Proposal is the first of three proposed regulations that FinCEN will issue to implement the CTA's legal entity reporting requirements, and addresses: (a) the legal

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entities that must file with FinCEN; (b) when filing must occur; and (c) the information that must be provided.⁵

This Alert describes each of these components of the Proposal, as well as provides observations regarding the impact the Proposal may have on the U.S. AML compliance process.

Reporting Requirements for Covered Legal Entities

The Proposal establishes two categories of reporting companies that must file reports with FinCEN—"Domestic Reporting Companies" and "Foreign Reporting Companies."

Subject to exemptions, discussed below, a Domestic Reporting Company is any entity that is created under State or federal law by the filing of a document with a Secretary of State or similar office of a jurisdiction within the United States. A Foreign Reporting Company is any entity formed under the law of a foreign (*i.e.*, non-U.S. jurisdiction) that is required to be registered to do business within the United States. As defined by the Proposal, the range of a legal entity that is a covered reporting company is extremely broad, and includes corporations, limited liability companies, statutory trusts and other similar legal entities created by the filing of a document with a Secretary of State's office (or similar office), including comparable offices operated by Indian Tribes.

Because the intent of the CTA is to capture BOI for legal entities whose ownership is not otherwise available, numerous exemptions are available for those legal entities whose ownership information is either public or readily obtainable, including:

- SEC reporting issuers;
- Governmental authorities;
- Banks;
- Credit unions;
- Depository institution holding companies;
- Money transmitters;
- Securities exchanges or clearing agencies;
- Other Exchange Act registered entities;
- Investment companies or investment advisers;
- Venture capital fund advisers;
- State-licensed insurance producers;
- Commodity Exchange Act registered entities;
- Accounting firms;⁶
- Public utilities;
- Financial market utilities;
- Pooled investment vehicles;
- Tax-exempt entities;
- Large operating companies;⁷
- Subsidiaries of certain exempt entities; and
- Inactive entities.⁸

As noted in the Proposal, FinCEN estimates that 2 to 3 million legal entities are created each year that would qualify as a reporting company (*i.e.*, not exempted). Further, all existing legal entities not otherwise exempted as of the effective date of the Proposal is finalized will likewise be required to register with FinCEN and provide BOI within 1 year of the effective date. (FinCEN estimates that the number of covered reporting companies in this category exceeds 30 million entities.)

The timing requirements for reporting companies to file with FinCEN are discussed immediately below.

Timing Requirements for Filing

Under the Proposal, the time at which a required report is due by a reporting company would be based upon: (a) the date the reporting company was created or registered; and (b) whether the report is an initial report, an updated report providing new information or a report correcting erroneous information in a previous report.

For Domestic Reporting Companies and Foreign Reporting Companies created or registered to do business in the United States prior to the effective date of the Proposal as finalized, those entities would have 1 year from the effective date of the final version of the Proposal to file their initial reports with FinCEN.

For Domestic Reporting Companies and Foreign Reporting Companies created or registered to do business in the U.S. subsequent to the effective date of the Proposal, those entities would be required to file their initial report with FinCEN within 14 calendar days of the date on which they are created or registered, respectively.

Finally in regard to all reporting companies, the Proposal would impose subsequent filing requirements. First, when there is a change in the information previously reported to FinCEN, a covered company would have 30 calendar days to file an updated report. Second, if a reporting company determines that it filed information that was inaccurate at the time of filing, the reporting company would have to file a corrected report within 14 calendar days of the date it knew, or should have known, that the information was inaccurate.

BOI Required to be Provided

A reporting company must file two general categories of information: (a) detailed information regarding the reporting company and its company applicant; and (b) beneficial ownership information (*i.e.*, BOI).

In regard to general information to be filed by a reporting company and its company applicant, information that must be provided includes:

- The full name of the reporting company;
- Any trade name or “DBA” name of the reporting company;
- The business address of the reporting company;

- The State or Tribal jurisdiction of formation of the reporting company (or for a Foreign Reporting Company, the State or Tribal jurisdiction where the Foreign Reporting Company first registers);
- A unique identifier associated with the reporting company, such as an IRS TIN or EIN;⁹
- The full legal name of the company applicant;
- The date of birth of the company applicant;
- The address of the company applicant; and
- A unique identifier of the company applicant, such as a passport, governmental ID or driver's license (including a photo of the individual).

In regard to a beneficial owner, the following information must be provided:

- The full legal name of the beneficial owner;
- The date of birth of the beneficial owner;
- The address of the beneficial owner; and
- A unique identifier of the beneficial owner, such as a passport, governmental ID or driver's license (including a photo of the individual).

It is important to note that the Proposal modifies the guidance of what constitutes beneficial ownership by including an expanded definition of the concept of "ownership interest." As compared to that concept in the CDD Rule, a reporting company appears to have some heightened degree inquiry to ascertain ownership and control of the reporting company. For example, the Proposal indicates that complex, multi-level ownership structures must be analyzed, and beneficiaries of a trust must now be considered as holding an ownership interest in a statutory trust (whereas the CDD Rule recognizes only the trustee of a trust to be the beneficial owner).

Observations

While through the public comment period the Proposal may be modified in some helpful ways (e.g., extending initial filing deadlines for current and new reporting companies), we believe that the overall structure as reflected in the Proposal will remain intact.

Assuming this conclusion is correct, we offer the following observations:

First, the Proposal reflects the compromise contained in the Defense Act between governmental agencies charged with anti-money laundering responsibilities and financial intermediaries seeking relief from burdensome BOI obligations that require confirmation of the data provided by covered legal entities. Practically, the Proposal creates separate and direct liability for reporting companies by imposing on those reporting companies the ongoing obligation to accurately report their BOI to FinCEN. Because a filing to be made under the Proposal will constitute a statement made to a federal agency, increased liability will accrue for intentional misstatements made by a reporting company.

Second, the burden of complying with the requirements of the Proposal as finalized will produce a sea-change in the structure of AML compliance. Besides FinCEN's statement as part of the Proposal that the CDD Rule will be modified in a future rulemaking,

covered legal entities will incur continuing legal liability that will place on those entities on-going updating and reporting of changes to ownership and management that relate to previously reported BOI.¹⁰

In that regard, considering that FinCEN estimates that 30 million existing legal entities will become subject to the Proposal when finalized, the effort necessary to educate existing reporting companies will be formidable. In the minimum, a tsunami of initial filings will be required, but the legal acumen held by owners and operators of small covered companies might practically result in marginal compliance in the immediate future.

Third, there has already been raised concerns by persons and entities who assist in the organization and registration of new reporting companies (*i.e.*, company applicants). For example, the state of incorporation for many small companies and similar entities is the State of Delaware. Both corporations and individuals engaged in incorporation activities have raised liability concerns if such persons and entities employing those persons are charged or delegated with accurately providing BOI data to FinCEN.

In that regard, as a general rule, company applicants organizing legal entities frequently do not engage in any significant degree of diligence regarding ownership and control of the entity being formed. If a company applicant is viewed as providing an initial filing to FinCEN, persons and entities that constitute or employ company applicants may be required to consider contractual representations regarding ownership interests in reporting companies, including record retention of BOI obtained. Similarly, in the instance in which a company applicant files in initial report with FinCEN for a reporting company, care may have to be exercised to clearly terminate future reporting responsibilities by the company applicant.

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As noted in this Alert, the Proposal only the first in a series of three regulatory proposals that will restructure the U.S. AML compliance scheme for legal entity BOI. Other components of the Act have not yet been proposed by FinCEN, but are likely to also radically modify current AML compliance obligations.

Future Alerts will address these and related regulatory initiatives that should be expected in 2022 and 2023.

¹ Public Law 116-283 (January 1, 2021). Division F of the Defense Act is the Anti-Money Laundering Act of 2020, which includes the Corporate Transparency Act.

² [Federal Register :: Beneficial Ownership Information Reporting Requirements; 2021-26548.pdf \(govinfo.gov\)](#). The Proposal followed an Advanced Notice of Proposed Rulemaking issued by FinCEN on April 5, 2021. [Federal Register :: Beneficial Ownership Information Reporting Requirements; 2021-06922.pdf \(govinfo.gov\)](#).

³ The Proposal defines a company applicant as an individual that either directs or controls the creation or registration of a reporting company. This would include, for

example, an attorney at a law firm that orders the incorporation of a new limited liability corporation through an intermediary filing service.

⁴ 31 C.F.R. § 1010.230.

⁵ The two additional proposed regulations to be issued by FinCEN will address: (i) the protocols for accessing the BOI database by permitted users; and (ii) revisions to existing CDD obligations by certain defined “financial institutions” pursuant to the CDD Rule.

⁶ A noteworthy omission from the list of exempted entities are law firms, whose members will frequently constitute “company applicants,” discussed below.

⁷ A large operating company is any entity that: (a) employs more than 20 full time employees in the United States; (b) has an operating presence at a physical office within the United States; and (c) has more than \$5 million in sales or operating revenue. (For a company that is part of an affiliated group of companies, the consolidated sales or revenues of the affiliated group may be used for this calculation.)

⁸ The CTA and the Proposal include the authority for the Secretary of the Treasury (in consultation with other federal agencies) to exclude by regulation additional types of entities.

⁹ When a reporting company has not yet been issued a TIN, alternative identification may be provided, including: (a) a Dun & Bradstreet Data Universal Numbering System Number; or (b) a “Legal Entity Identifier” (to be issued by FinCEN).

¹⁰ On December 15, 2021, FinCEN issued a request for public comment seeking public input for proposals to modernize the overall U.S. AML compliance regime. See, Federal Register :: Review of Bank Secrecy Act Regulations and Guidance.