

## Legal Sidebar

# FinCEN Seeks Shell-Company Transparency

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In May 2016, Treasury’s Financial Crimes Enforcement Network (FinCEN) released [final rules](#) outlining anti-money laundering due diligence requirements for certain financial institutions that include for the first time a mandate to identify and verify beneficial owners of legal entity customers. At the same time, Secretary of the Treasury Jacob J. Lew [wrote](#) to congressional leaders urging ratification of pending tax treaties and enactment of legislation to establish a federal database reflecting the beneficial ownership of newly established companies in the United States. He also advocated [legislation](#) to require U.S. financial institutions to provide foreign jurisdictions with information on accounts held for foreign nationals similar to [the information that financial institutions abroad must supply on accounts held for U.S. persons](#) under the [Foreign Account Tax Compliance Act \(FATCA\)](#). These actions, summarized in a Department of the Treasury [press release](#), aim to increase transparency to fill gaps in the U.S. anti-money laundering/anti-terrorist financing arsenal. They come soon after the April 2016 leak of the “Panama Papers,” [a database released by the International Consortium of Investigative Journalists](#), exposing documents used by a Panama law firm to set up shell companies for thousands of clients around the world. These revelations have drawn attention to the ability of criminals and terrorists to hide behind shell companies (both off-shore and domestically) to hide the proceeds of illegal activity (i.e., money laundering) or to shelter funds illegally from home country taxes.

The new “Customer Due Diligence for Financial Institutions” regulations were issued under [FinCEN’s authority under the Bank Secrecy Act \(BSA\)](#). They prescribe a two-year implementation period. FinCEN has been developing them since issuing an [Advance Notice of Proposed Rulemaking](#) in March 2012, which was followed by a series of hearings, a [Notice of Proposed Rulemaking](#) in August 2014, and publication of information on FinCEN’s [regulatory impact assessment and regulatory flexibility analysis](#) (assessing cost-benefit analysis) in December 2015. The regulations cover a limited group of financial institutions that are currently required to develop anti-money laundering programs—banks, securities brokers or dealers, mutual funds, futures commission merchants, and introducing brokers in commodities. The final regulations specify four pillars of customer due diligence (CDD) programs:

- [Written procedures to identify and verify the identity of accountholders](#). These requirements have been in effect since being mandated by [section 326 of the USA PATRIOT Act](#).
- Procedures to identify and verify beneficial owners of legal entity customers opening new accounts. These are new requirements which become effective on May 11, 2018. They include a form that the person opening an account for a legal entity may use to supply required identifying information—name, address, and Social Security Number (for U.S. citizens) or Passport Number (for foreign individuals). Identification is required for individual beneficial owners owning 25% or more of the legal entity and for one individual in the management of the entity. Verification must be risk-based and may be by photocopies of documents.
- Procedures to gather information from customers for the financial institution’s development of a risk profile. This requirement makes explicit what has been an implicit component of BSA compliance programs. Covered institutions are required to file [Suspicious Activity Reports \(SARs\)](#) and to develop and implement anti-money laundering programs.
- Procedures for ongoing monitoring to report suspicious transactions and update customer information on a risk basis. By requiring ongoing monitoring, the new regulation makes an explicit requirement of a practice presently viewed as a necessary ingredient of an adequate anti-money laundering compliance program for covered financial institutions. Under the current SAR [regulations](#), for example, banks must file an SAR on any “transaction that has no business or apparent lawful purpose or is not the sort in which the particular customer

would normally be expected to engage, and the bank knows of no reasonable explanation for the transaction after examining the available facts ....” Without establishing a profile of the customer’s usual business and financial transactions and updating it, the bank would be unable to spot out-of-ordinary transactions for further scrutiny for possible SAR reporting.

[Treasury’s legislative proposal](#) consists of two amendments to the BSA. The first would authorize the Secretary of the Treasury to “require any United States entity to maintain records and file reports on the beneficial owners of such entity.” It would define “United States Entity” and “Beneficial Owner” broadly. Violations would be subject to civil penalties of \$5,000 per violation for each day the violation continues. The second proposal would amend the [BSA provision](#) governing the issuance of geographic targeting orders (GTOs) to remove language confining the authority to monetary instruments and replace it with language covering “funds,” and, according to Treasury, thereby including wire transfers. GTOs are FinCEN localized reporting requirements. For example, in January 2016, FinCEN issued [GTOs](#) requiring title insurance companies to file reports identifying individuals behind companies making cash purchases of high-value real estate in Manhattan and Miami.

The need for greater transparency about beneficial owners has drawn attention in the 114<sup>th</sup> Congress. It is the subject of at least three bills which have been introduced and has been mentioned in House hearings. [H.R. 297](#) and [S. 174](#) include provisions requiring reporting U.S. beneficial owners of foreign-owned accounts, and [H.R. 4450](#) includes provisions mandating disclosure of the beneficial owners of corporations and limited liability companies. In addition, [testimony](#) during the current Congress before the House Financial Services Task Force to Investigate Terrorist Financing has addressed the need for identification of beneficial owners of shell companies so that terrorist transactions are not shielded from discovery. There has also been international attention. The European Union (EU) Parliament’s [Fourth Annual Anti-Money Laundering Directive, enacted in 2015](#), includes heightened due diligence for financial institutions and requires that EU member nations establish registries of the beneficial owners of corporations and other legal entities by June 2017.

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