

DECEMBER 17, 2021

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FinCEN Requests Comments on Beneficial Ownership Reporting Requirement; FinCEN's Request For Information Moves U.S. Towards Modernization Of BSA/AML Regime

The United States Department of the Treasury ("Treasury") is taking further action to combat corruption, money laundering, terrorist financing, tax fraud, and other illicit activities.

Following its Advance Notice of Proposed Rulemaking requesting extensive feedback on a range of issues related to beneficial ownership disclosure requirements earlier this year, including privacy to compliance concerns,¹ Treasury's Financial Crimes Enforcement Network ("FinCEN") issued a Notice of Proposed Rule Making ("NPRM") on December 7, 2021, to allow the public to comment on a proposed rule implementing the Corporate Transparency Act ("CTA").² FinCEN is requesting public comments, preferably in the form of responses to a specific list of questions set out in the Notice. Comments in response to the NPRM must be submitted no later than February 22, 2022.

The proposed rule addresses which companies must file (and who is exempt), when they must file, and what information they must file about themselves and their respective beneficial owners and individual applicants. FinCEN intends to issue separate rulemakings to implement other aspects of Section 6403 of the CTA, including protocols for access to and disclosure of information and revisions to FinCEN's existing customer due diligence requirements.³

The CTA was passed as a part of the Anti-Money Laundering Act of 2020 ("AMLA"), itself a part of the National Defense Authorization Act for Fiscal Year 2021. As discussed in previous client alerts, the CTA presents a consequential shift in the transparency of the beneficial ownership of many companies in the United States.⁴ Implementing the CTA's beneficial



reporting requirements is one of many coordinated efforts among departments and agencies to decrease corruption and money laundering in the United States. Regarding the proposed beneficial ownership rule, Treasury Secretary Janet Yellen stated, “[t]he proposed rule for beneficial ownership reporting is a major step toward addressing the gaps in our corporate transparency framework that allow corruption to flourish and illicit funds to flow into the United States. The beneficial ownership rule will help close the loopholes that undermine U.S. national security, bolster economic fairness, and protect the integrity of our financial system.”⁵

Another significant effort in establishing the framework for tackling domestic and foreign corruption, money laundering, and the financing of terrorism is the recently published United States Strategy on Countering Corruption, which catalogs additional actions agencies and departments may take in the near future to combat money laundering and corruption.⁶ The strategic objectives outlined in this framework for combatting corruption include “effective beneficial ownership regulations, and building a database of the beneficial owners of certain companies, in order to help domestic and international partners identify bad actors”

NPRM OVERVIEW

The proposed rule would require certain companies (the “Reporting Companies”) to file reports with FinCEN that disclose the identity and certain personal information concerning two categories of individuals: (1) the beneficial owners of the entity; and (2) individuals who file an application with specified governmental or tribal authorities to form the entity or register it to do business.

In addition to the two categories of individuals, the NPRM focuses on the following areas and asks specific questions related to Domestic Reporting Companies, Foreign Reporting Companies, Beneficial Owners, Substantial Control, Company Applicant, Beneficial Ownership Information Reports, and Beneficial Ownership Information Report timing.

DOMESTIC REPORTING COMPANIES, FOREIGN REPORTING COMPANIES, AND COMPANY APPLICANTS

The proposed rule recognizes two types of Reporting Companies, domestic and foreign, and defines them as follows: a Domestic Reporting Company is defined as any company or entity created by filing a document with a secretary of state or similar office under the law of a state or tribal jurisdiction and a Foreign Reporting Company includes any corporation or entity formed under the law of a foreign country that is registered to do business in any state or tribal jurisdiction. Notably, the proposed definition of Company Applicant includes any individual who directs or controls the filing of such a document by another person.

Certain trusts are also included in these definitions, but FinCEN recognizes that the creation of various trusts does not require filing a formation document. FinCEN has also proposed to adopt the list of 23 categories of entities that are already identified as exempt from the CTA, such as securities issuers that file public reports with the Securities & Exchange Commission, banks, brokers, registered investment corporations, tax-exempt entities, and insurance companies. These entities are exempt from the CTA reporting requirements because they are already subject to existing substantial federal or state regulation which mandates beneficial ownership reporting.

Additionally, FinCEN recognizes that the CTA’s definition creates ambiguity regarding the exempt status of certain entities. Therefore, FinCEN plans to address the ambiguity by defining specific types of entities (e.g., public utilities).

BENEFICIAL OWNERS & SUBSTANTIAL CONTROL

A beneficial owner would include any individual that exercises: (1) substantial control over a Reporting Company, or (2) owns or controls at least 25 percent of the ownership interest of a Reporting Company. The proposed rule will define substantial control by specifying a range of activities that could have that effect. The activities specified will result in the inclusion of anyone who is able to make a significant decision on behalf of the entity. More specifically, the proposed



rule identifies three indicators of “substantial control”: (1) service as a senior officer of a reporting company; (2) authority over the appointment or removal of any senior officer or dominant majority of the board of directors (or similar body) of a reporting company; and (3) direction, determination, or decision of, or substantial influence over, important matters (a number of which are spelled out) of a Reporting Company.⁷ The regulation also contains a “catch-all” provision that makes clear that “substantial control” might arise from other factors (e.g. approval of significant debt, entry into or termination of a contract, or amending governance documents of the Reporting Company⁸) as well. Departing from the Customer Due Diligence rule, which is limited to beneficial ownership disclosure of “legal entity customers” of certain financial institution when those companies open new accounts, FinCEN seeks to expand the definition of “substantial control” such that it is not necessarily limited to one individual, thereby broadening the number of individuals deemed beneficial owners in order to close loopholes obscuring the owners or decision-makers during the corporate formation process.

The proposed rule also proposes to exempt five types of individuals from the definition of “beneficial owner,” namely:

- (1) A minor child, as defined under the law of the State or Indian tribe in which a Domestic Reporting Company is created or a Foreign Reporting Company is first registered, provided the Reporting Company reports the required information of a parent or legal guardian of the minor child;
- (2) An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual;
- (3) An employee of a Reporting Company, acting solely as an employee and not as a senior officer, whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee;
- (4) An individual whose only interest in a Reporting Company is a future interest through a right of inheritance; and
- (5) A creditor of a Reporting Company.

BENEFICIAL OWNERSHIP INFORMATION REPORTING

Reporting Companies are required to identify their beneficial owners and four pieces of information about their beneficial owners and company applicants. Reporting Companies can use the following information for identification:

- Name;
- Date of birth;
- Address; and
- Unique identifying number from an acceptable identification document.

Alternatively, an individual can apply for a “FinCEN identifier,” allowing the individual to provide the identifier to a Reporting Company. This would eliminate the need for the individual to supply the above information directly to the Reporting Company. The Reporting Company would only need to include the FinCEN identifier of the individual in its report.

TIMING OF REPORTING

The proposed rule also specifies the time at which beneficial ownership information must be reported. The timing of the report will depend on two factors: (1) when a Reporting Company was created or registered, and (2) whether the report at issue is an initial report, an updated report, or a report correcting erroneous information. Willfully failing to report complete or updated beneficial ownership information to FinCEN may lead to a civil penalty of up to \$500 for each day a



violation continues or has not been remedied. Further, the individual may be fined up to \$10,000 and imprisoned for up to two years, or both, for a criminal violation.

Domestic and Foreign Reporting companies created or registered before the effective date will have a year to file their initial reports. Domestic or Foreign Reporting companies created or registered after the effective date will have 14 days to submit their initial filing. A Reporting Company must submit updates to a previous filing within 30 days and within 14 days of discovering or having reason to suspect an error.

NOTABLE TAKEAWAYS

Significantly, the proposed rule notes: “this rulemaking process will touch on the issue of the interplay between the FinCEN-hosted beneficial ownership information technology (IT) system and financial institutions’ diligence efforts.” The expectation is that this beneficial ownership database will help facilitate the ability of bank compliance teams to obtain information as part of their due diligence process, while also providing a valuable tool for law enforcement. The ultimate effectiveness of this database likely will depend on the access protocols that are adopted to obtain the beneficial ownership information, as well as on the measures instituted to ensure the veracity of such information.

Additionally, given that the formation of some trusts does not require any registration under state law, resulting in avoidance of these new requirements, FinCEN is requesting comment on whether the definition of a “Reporting Company” needs to be expanded.⁹ As beneficial ownership information regarding trusts is not currently required by covered financial institutions under their customer due diligence obligations because the trustee is generally treated as the beneficial owner, FinCEN proposes, however, to specify that an individual who directly or indirectly owns or controls an ownership interest in a Reporting Company through a trust or similar arrangement may, in certain circumstances, be treated as a beneficial owner.¹⁰

REVIEW OF BANK SECRECY ACT REGULATIONS AND GUIDANCE

As required by the AMLA, on December 14, 2021, FinCEN also issued a request for information (“RFI”) on ways to modernize the regulatory framework under the Bank Secrecy Act (“BSA”) to combat money laundering and terrorist financing as well as other related financial crimes.¹¹ FinCEN recognizes that illicit finance threats are evolving and is requesting input on potentially new and innovative risk-based approaches to protect the U.S. financial system. More specifically, FinCEN is soliciting comments on additional risks to the U.S. financial system and national security that are not being addressed by current regulatory safeguards and an assessment of the effectiveness of currently required reports or records to counter financial crime (e.g., suspicious activity reports, currency transaction reports). The formal review also is intended to enable FinCEN to identify BSA regulations and guidance that are outdated, redundant, or otherwise do not promote a risk-based AML/CFT compliance regime for financial institutions, or that do not conform with U.S. commitments to meet international AML/CFT standards (namely, those issued by the Financial Action Task Force). Comments on the RFI are due by February 14, 2022.

CONCLUSION

The NPRM provides interested parties a vital opportunity to comment on fundamental aspects of FinCEN’s beneficial ownership disclosure regulations under the CTA. Interested parties should review the questions in the NPRM and take advantage of this opportunity to help ensure that FinCEN devises an efficient and effective system that facilitates their ability to meet their due diligence obligations, thereby reducing the costs of compliance. The RFI provides for a comprehensive review of BSA regulations and guidance, including whether they are serving their purpose to protect the U.S. financial system against money laundering, the financing of terrorism and proliferation, and other financial crimes that pose a threat to national security.



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¹ See FinCEN Issues Proposed Rule for Beneficial Ownership Reporting to Counter Illicit Finance and Increase Transparency, (Dec. 2021), available at: <https://www.fincen.gov/news/news-releases/fact-sheet-beneficial-ownership-information-reporting-notice-proposed-rulemaking>.

² Beneficial Ownership Information Reporting Requirements, 86 Fed. Reg. 69,920 (Dec. 8, 2021), available at: <https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-26548.pdf>.

³ FinCEN, *supra* note 1.

⁴ See FinCEN Seeks Comments on CTA Beneficial Ownership Regulations (Dec. 2021), available at: <https://www.kslaw.com/news-and-insights/fincen-seeks-comments-on-cta-beneficial-ownership-regulations>.

⁵ Press Release, U.S. Department of the Treasury, Statement by Secretary of the Treasury Janet L. Yellen on FinCEN's Proposed Rule for Beneficial Ownership Reporting (Dec. 7, 2021).

⁶ See United States Strategy on Countering Corruption (Dec. 6, 2021), available at: <https://www.whitehouse.gov/wp-content/uploads/2021/12/United-States-Strategy-on-Countering-Corruption.pdf>

⁷ See Beneficial Ownership Information Reporting Requirements, 86 Fed. Reg at 69,920.

⁸ See *id* at 69,972 - 69,973.

⁹ See *id* at 69,946.

¹⁰ See *id* at 69,935.

¹¹ See FinCEN Seeks Comments on Modernization of U.S. AML/CFT Regulatory Regime, (Dec. 2021), available at: <https://www.fincen.gov/news/news-releases/fincen-seeks-comments-modernization-us-amlcft-regulatory-regime>