Congress Enacts Significant Changes to the U.S. Anti-Money Laundering Regime

Authored by Thomas Bogle, Christopher Christian, Darshak Dholakia, Michael Gilbert, Jeremy Zucker, Robert Rhatigan, and Mariel Bronen

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The Anti-Money Laundering Act of 2020 (AML Act), enacted on January 1, 2021 as part of the National Defense Authorization Act for Fiscal Year of 2021 (NDAA), makes several significant changes to U.S. anti-money laundering (AML) laws and regulations. Financial institutions that are subject to U.S. AML requirements under the Bank Secrecy Act (BSA), as well as other entities that have implemented AML compliance programs, must carefully assess the impact of these changes on their current activities.

This *OnPoint* summarizes key provisions of the AML Act, including: (i) enhanced beneficial ownership reporting requirements; (ii) expanded authorities for enforcement, subpoenas and whistleblower protection; and (iii) expanded coordination and transparency efforts.

Beneficial Ownership Reporting Requirements

The most significant aspect of the AML Act involves the Corporate Transparency Act (CTA), which establishes new reporting requirements for legal entities and a new beneficial ownership registry to be maintained by FinCEN to "combat the abuse of anonymous companies, which can be used to facilitate money laundering, the financing of terrorism, proliferation finance, tax evasion, human and drug trafficking, sanctions evasion, and other financial crimes."[1] The CTA addresses a deficiency in the U.S. legal and regulatory framework to combat money laundering and terrorist financing noted by the Financial Action Task Force in its Mutual Evaluation Report of the United States.[2] The implementation of the CTA will impose new requirements on many legal entities, including certain private funds that now will be required to report beneficial ownership information to FinCEN, as described more fully below.

In addition, the CTA requires FinCEN to promulgate regulations to implement the principles of the CTA no later than one year from the date of enactment – January 1, 2021. The CTA also requires FinCEN to make certain changes to its beneficial ownership requirements adopted as part of its Customer Due Diligence Rule[3] (CDD Rule), to make such requirements consistent with the CTA.

Reporting Requirements

Under the CTA, each "reporting company" will be required to submit a report to FinCEN identifying each "beneficial owner" and each "applicant" of the reporting company (UBO Report). The UBO Report must be submitted at the time of formation of the reporting company, and the UBO Report must be updated within one year of any change to the information required therein.

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[1] *See* Conference Report HR 6395 William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (p. 4458). For further information about the NDAA, please refer *to Dechert OnPoint*, Congress Restores and Codifies Expansive SEC Disgorgement Authority.

[2] *See* Financial Action Task Force, Mutual Evaluation Report of the United States (December 2016).

[3] The CDD Rule, which went into effect in May 2018, requires that financial institutions, among other things, collect information from their "legal entity customers" to identify and verify the beneficial owners of such customers. For further information, please refer to *Dechert OnPoint*, FinCEN Issues FAQs for Customer Due Diligence Rule; Compliance Required in May.

The information required to be collected by FinCEN with respect to each beneficial owner and applicant of a reporting company includes:

- Full legal name;
- Date of birth;
- Current residential or business street address (as of the date on which the report is delivered); and
- Either (i) a unique identifying number from an acceptable identification document (e.g., passport or driver's license) or (ii) a FinCEN Identifier.

Unlike FinCEN's current beneficial ownership requirements, the CTA does not require individuals to submit a social security number. Instead, the CTA only requires individuals to provide a unique identifying number from an acceptable identification document, which may include a non-expired U.S. passport, as well as any non-expired identification document issued by a state or local government or an Indian Tribe. For non-U.S. resident individuals, a non-expired passport issued by a foreign government would be required.

In addition, the CTA requires FinCEN to promulgate rules permitting the use of a FinCen Identifier by reporting individuals and entities, which may be issued a FinCEN identifier that can be used by such reporting individuals or entities, in lieu of the identifying information described above each time the information is required. The CTA also permits a reporting company to provide to FinCEN a FinCEN Identifier of a direct or indirect shareholder that is a legal entity, in lieu of that shareholder providing the personal information of each of its beneficial owners. Further, the CTA does not require a reporting company to look through a direct or indirect shareholder, if the shareholder itself is an exempt entity (as discussed below).

The CTA sets forth the following relevant definitions:

- ***Beneficial Owner*** means "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise": (i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests of the entity.

  It is unclear what "substantial control" means in this context, as the term is undefined. However, the term beneficial owner does not include "an individual acting solely as an employee" of the reporting company, and "whose control over or economic benefits from such entity is derived solely from the employment status" of the reporting company. This would appear to be a departure from FinCEN's current beneficial ownership rule, which requires information about a "control person," which term includes a person with "significant responsibility to control, manage, or direct a legal entity customer."[4]

  The term also does not include: creditors (unless the creditor owns 25% or more of the entity or controls the entity); minors (provided information about the parent or guardian is collected); individuals acting as nominees, intermediaries, custodians, or agents acting on behalf of other individuals; or individuals whose only interest in the entity is through a right of inheritance.

- ***Applicant*** means: the individual who "files an application to form" the reporting company; or the individual who "registers or files an application to register" a reporting company that is "formed under the laws of a foreign

[4] *See* definition of "beneficial owner" as set forth in 31 C.F.R. § 1010.230(d).

country to do business in the United States by filing a document with the secretary of state or similar office of a State or Indian Tribe."

- ***Reporting Company*** means "a corporation, limited liability company, or other similar entity that is: (i) created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe; or (ii) formed under the law of a foreign country and registered to do business in the United States by filing of a document with a secretary of state or similar office under the laws of a State or Indian Tribe."

  Importantly, the legal entity must be formed by the "***filing of a document***" with the relevant state authority – this generally would not capture common law trusts or other types of entities formed by agreement or contract with no filing required.

Excluded Entities

There are a number of entity types excluded from the definition of reporting company, most of which are currently required to provide beneficial ownership to their respective regulators. Such excluded entities include, among others:

- Exchange-traded issuers and issuers required to file supplementary and periodic information under Section 15(d) of the Securities Exchange Act of 1934;
- Bank holding companies, savings and loan holding companies, banks,[5] savings and loan companies, and federal and state-chartered credit unions;
- Broker-dealers registered with the SEC;
- Investment companies registered under the Investment Company Act;
- Investment advisers registered with the SEC under the Advisers Act;
- Venture capital fund advisers, as described in Section 203(l) of the Advisers Act and that have filed Item 10 of Schedule A, and Schedule B of Part 1A, of Form ADV (Venture Capital Fund Advisers);
- Certain pooled investment vehicles (as discussed below); and
- Futures Commissions Merchants, Introducing Brokers in commodities, Swap Dealers, Major Swap Participants, Commodity Pool Operators and Commodity Trading Advisors (each as defined in CFTC rules and regulations).[6]

[5] The term "bank" is as defined in the Section 3 of the Federal Deposit Insurance Act, Section 2(a) of the Investment Company Act, or Section 202(a) of the Advisers Act. Accordingly, certain entities may need to assess whether they meet the definition of bank (*e.g.*, state-chartered non-depository trust companies and special purpose depository institutions that do not require FDIC insurance).

[6] The CTA also excludes from the definition of reporting company: governmental entities established under the laws of the United States, an Indian Tribe, a state, or a political subdivision thereof; money transmitters registered with FinCEN; securities exchanges or clearing agencies registered with the SEC; any other entity registered with the SEC; insurance companies (as defined in the Investment Company Act) and insurance producers with an operating presence at a physical location within the United States; retail foreign exchange dealers and any entity that is a "registered entity" as defined in the Commodity Exchange Act (*e.g.*, designated clearing organizations and swap execution facilities); public utilities; financial market utilities designated as such by the Financial Stability Oversight Council; and a range of other charitable and political entities under the Internal Revenue Code).

Pooled Investment Vehicles

Pooled investment vehicles formed in the United States and advised by an SEC-registered investment adviser, a Venture Capital Fund Adviser, bank, credit union, or SEC-registered broker-dealer do not have to file UBO Reports. Although the CTA excludes pooled investment vehicles from the requirement to file UBO Reports, the definition of "pooled investment vehicle" is narrowly tailored to not include certain private investment funds, as described more fully below.

The CTA defines "***pooled investment vehicle***" as:

- An investment company as defined in Section 3(a) of the Investment Company Act; or
- Any company that would be an investment company but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act, and which is identified by its legal name by the applicable adviser in its Form ADV.

Pooled investment vehicles formed outside of the United States but that are advised by the above-listed U.S. entities must file a "written certification that provides identification information of an individual that exercises substantial control of the pooled investment vehicle," but do not need to include beneficial ownership information.

Requirement to File UBO Reports by Fund Category

Private Funds and Offshore Funds

A UBO Report must be filed by private funds that are advised by: exempt reporting advisers relying on the Private Fund Adviser Exemption (under Section 203(m) of the Advisers Act); or state-registered investment advisers not registered with the SEC. Conversely, as noted above, private funds advised by an SEC-registered investment adviser or a Venture Capital Fund Adviser are not required to file a UBO.

Offshore funds operated or advised by an SEC-registered investment adviser, Venture Capital Fund Adviser, bank, credit union, or broker-dealer must provide information on one control person of the fund. Absent further guidance, it appears that certain publicly offered collective investment vehicles advised or sub-advised by an SEC-registered investment adviser would be required to provide control person information, but not a UBO Report.

Other Issuers Exempt from Investment Company Status

Because the definition of pooled investment vehicle does not capture issuers that rely on exemptions from the definition of investment company other than under Sections 3(c)(1) or 3(c)(7), other types of funds and vehicles may be required to file UBO Reports. For example, asset-backed securities issuers that may rely on Section 3(c)(5) of the Investment Company Act to avoid investment company status would not be pooled investment vehicles under the CTA. However, if the issuer is identified as a private fund in the Form ADV of the adviser (or collateral manager or entity serving in a similar role), then it appears the issuer would come within the definition of pooled investment vehicle as defined in the CTA.

Commodity Pools

Commodity pools that do not invest in securities, and therefore are not investment companies as defined in Section 3 of the Investment Company Act, would not qualify as pooled investment vehicles. Accordingly, such a commodity pool would need to file a UBO Report unless it can fit within another exclusion from the definition of reporting company. To the extent a commodity pool is subject to the information requirements of Section 15(d) of the Exchange

Act (*e.g.*, a retail commodity pool), it would not need to file a UBO Report. However, a commodity pool that relies on CFTC Rule 4.7 would be required to file a UBO Report, even if it is advised or operated by a commodity pool operator or commodity trading advisor.

Investment Companies, Business Development Companies and Small Business Investment Companies

As noted above, investment companies registered under the Investment Company Act are excluded from the definition of reporting company and do not need to file a UBO Report. This would include mutual funds, exchange-traded funds, and listed and unlisted closed-end funds. Business development companies, which are investment companies that are exempt from registration under the Investment Company Act because they have elected to be treated as BDCs, would be able to rely on the pooled investment vehicle exclusion because they are advised by exempt companies, or because they are subject to Exchange Act reporting requirements.

Small business investment companies (SBICs) are not specifically addressed in the CTA. SBICs generally rely on Section 3(c)(4) of the Investment Company Act to be exempt from the definition of investment company. Accordingly, because SBICs are not investment companies as defined under Section 3 of the Investment Company Act, and do not rely on Sections 3(c)(1) or 3(c)(7), SBICs do not fit within the definition of pooled investment vehicle under the CTA. Although advisers to SBICs may rely on the Venture Capital Fund Adviser exemption, the SBIC itself would not fit within the pooled investment vehicle definition under the CTA, because it does not rely on Sections 3(c)(1) or 3(c)(7).

Bank Common and Collective Trusts

Bank common and collective trust funds are generally common law contractual trust arrangements that are not formed by making a filing with a state. Accordingly, bank common and collective trust funds would not fall under the definition of reporting company in the CTA.

FinCEN Regulations and Rescission of Beneficial Ownership Requirements under the CDD Rule

The CTA requires FinCEN to revise its Customer Due Diligence Rule and rescind paragraphs (b) through (j) of its beneficial ownership requirements under 31 C.F.R. § 1010.230, in order to bring the CDD Rule and beneficial ownership requirements into conformance with the CTA. The CTA expressly provides that nothing therein shall be construed as authorizing FinCEN to repeal the requirement that covered financial institutions must gather beneficial ownership information from their customers. In promulgating amendments to the CDD Rule and beneficial ownership requirements, FinCEN is required to consider "the use of risk-based principles for requiring reports of beneficial ownership information." It is unclear how FinCEN will implement these requirements through its rulemaking, but financial institutions will need to continue collecting this information from customers who open new accounts.

Sharing of Beneficial Ownership Information

The CTA requires FinCEN to keep information contained in UBO Reports for at least five years. The CTA also includes confidentiality provisions and, subject to certain exceptions, prohibits disclosure of: information contained in UBO Reports by any "officer or employee" of the United States, and any state, local or Tribal agency; or any financial institution or regulatory agency receiving such information. FinCEN may disclose UBO Reports under certain conditions, upon receipt of "a request, through appropriate protocols" to certain Federal agencies engaged in "national security, intelligence or law enforcement activity," and to certain international investigatory and law enforcement bodies pursuant to international treaties. Financial institutions also may request UBO Reports from

FinCEN, provided the reporting company consents to the disclosure in connection with the financial institution's customer due diligence obligations under the CDD Rule.

The CTA imposes criminal and civil penalties for willful reporting violations as well as unauthorized disclosure or use violations. Any person who willfully provides or attempts to provide false information in a UBO Report, or who willfully fails to provide complete or update beneficial ownership information, is subject to a civil penalty of not more than $500 per day during the period the violation occurred and has not been remedied, as well as criminal penalties of not more than $10,000, up to two years imprisonment, or both. Willful violations of the disclosure and unauthorized use prohibitions are subject to the same civil monetary penalties, as well as criminal penalties of up to $250,000, up to five years imprisonment, or both. The CTA provides a conditional safe harbor for any violations, provided the UBO Report is corrected within 90 days.

Timing

The CTA mandates that FinCEN promulgate rules to implement the CTA requirements within one year of enactment. The CTA further provides that reporting companies formed after effectiveness of any implementing regulation must file a UBO Report upon formation of the entity, and will be required to update UBO Reports within one year of any changes to the reporting company's beneficial ownership information. Existing entities will have two years from the effective date of FinCEN's implementing regulations to file UBO Reports.

Expanded Authorities for Subpoenas, Enforcement and Whistleblowers

The AML Act makes several important changes to the ability of the United States government to investigate and enforce violations of AML laws and regulations. Key provisions are highlighted below.

Expanded Subpoena Power over Foreign Correspondent Accounts for Government Regulators

Section 6308 of the AML Act expands the ability of the Secretary of the Treasury and the Attorney General to subpoena foreign banks that maintain correspondent accounts in the United States. The government may now subpoena not only records related to correspondent accounts, but also *any account* at the foreign bank, including records maintained outside of the United States.

The enforcement provisions of Section 6308 empower federal district courts to compel compliance with a subpoena issued pursuant to that section, by holding the foreign bank in contempt and imposing civil penalties, which may be seized from the foreign bank's correspondent account at a U.S. financial institution. A U.S. financial institution also may be required to terminate a correspondent relationship with a foreign bank that has failed to comply with such a subpoena. A U.S. financial institution's failure to terminate the correspondent relationship may result in a civil penalty of up to $25,000 per day until the relationship is terminated.

The AML Act also includes a nondisclosure provision, which prohibits foreign banks from notifying account holders involved, or any person named in the subpoena, about the existence or contents of the subpoena. In the event of a violation of the nondisclosure provision, the Attorney General may seek civil penalties of double the amount of the suspected criminal proceeds sent through the foreign correspondent account, or if no such proceeds can be identified, up to $250,000.

Increased BSA Penalties

The AML Act expands the penalties for certain violations of the Bank Secrecy Act and rules and regulations issued pursuant to the BSA. For example, Section 6309 of the AML Act permits the Secretary of the Treasury to impose additional civil penalties for repeat violators, in the amount of three times the profit gained or loss avoided as a result of each violation, or twice the maximum penalty with respect to the violation.

Section 6310 of the AML Act also bars anyone found guilty of an "egregious violation" from serving on the board of a financial institution for 10 years following the conviction or judgment. Egregious violations include criminal violations with a maximum term of imprisonment of more than one year, as well as civil violations that are committed willfully and that facilitated money laundering or financing of terrorism.

Section 6312 of the AML Act imposes a fine equal to the profit gained by the violator as a result of the violation and, if the violator was a partner, director, officer, or employee of a financial institution at the time of the violation, such individual must repay any bonus they received during the calendar year following the violation.

Whistleblower Incentives and Protections

Section 6314 of the AML Act contains whistleblower incentives and protections, including several updates of and changes to the existing AML whistleblower program. Under those provisions, individuals and groups of individuals who provide original information about violations of the BSA to an employer, the Secretary of the Treasury or the Attorney General, which information leads to a successful enforcement action resulting in monetary sanctions over $1 million, are now eligible for awards of up to 30% of the amount of monetary sanctions collected in those actions. Awards previously were capped at $150,000.

The amount of the award is left to the discretion of the Secretary of the Treasury, who must take into account the following factors:

- The significance of the information provided to the success of the action;
- The degree of assistance provided by the whistleblower and any legal representative of the whistleblower;
- The interest in deterring violations by making awards to whistleblowers who provide information that leads to the successful enforcement; and
- Additional relevant factors established by rule or regulation.

Certain types of whistleblowers are ineligible to receive awards, including those that acquired the original information as: a member, officer or employee of a regulatory or banking agency, the Department of Treasury, the Department of Justice or a law enforcement agency; members, officers or employees that acquired the original information "acting in the normal course of the job duties of a whistleblower"; anyone "convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award under [the relevant] section"; and anyone who fails to submit information to the Secretary of the Treasury or Attorney General in accordance with any rules such officials adopt.

The whistleblower program also contains new protections, including provisions prohibiting employers from discharging, or discriminating or retaliating against whistleblowers as a result of their whistleblowing activities.

Expanded Availability of Disgorgement in SEC Actions under the Federal Securities Laws

Section 6501 of the AML Act includes an update to Section 21(d) of the Exchange Act, which makes clear the availability of disgorgement in SEC civil enforcement actions, stating that in "any action or proceeding brought by the [SEC] under any provision of the securities laws, the [SEC] may seek, and any Federal court may order, disgorgement."

Section 6501 also includes a generous statute of limitations provision for disgorgement and equitable relief. The SEC's ability to obtain disgorgement previously was limited to five years in all circumstances, in accordance with the Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), which held that claims for disgorgement brought by the SEC were punitive and, thus, subject to a five-year statute of limitations.[7] Under the new law, the SEC must bring any claim for disgorgement no later than five years after the latest date of the violation that gives rise to the action, or no later than ten years if the relevant conduct violates: (i) Section 10(b) of the Exchange Act; (ii) Section 17(a)(1) of the Securities Act of 1933; (iii) Section 206(1) of the Advisers Act; or (iv) any other provision of the securities laws for which scienter must be established. With respect to equitable relief (including an injunction, bar, suspension or cease-and-desist order), the SEC must bring a claim no later than 10 years after the latest date of the violation that gave rise to the action. These statutes of limitations are tolled while the defendant is outside the United States.

Enhanced Coordination and Transparency Efforts

The AML Act makes several changes intended to facilitate information sharing among government agencies and financial institutions. Key provisions are highlighted below.

Sharing of Suspicious Activity Reports with Non-U.S. Branches, Subsidiaries and Affiliates

Currently, financial institutions generally are restricted from sharing information related to Suspicious Activity Reports (SARs) with their non-U.S. subsidiaries and affiliates (except in certain limited circumstances). However, Section 6212 of the AML Act will relax these restrictions by requiring the U.S. Treasury Department to establish a pilot program – within one year of the AML Act's enactment – under which financial institutions can share information regarding SARs with their non-U.S. branches, subsidiaries, and affiliates. Any such information sharing must be subject to appropriate data security requirements related to personally identifiable information. Moreover, the Treasury Department will be prohibited from extending the pilot program to include: branches, subsidiaries and affiliates of financial institutions in Russia, China; jurisdictions that are state sponsors of terrorism or subject to sanctions imposed by the federal government,;or other jurisdictions where the Treasury Department has determined that the jurisdiction cannot reasonably protect the information.

Formalization of FinCEN Exchange

Section 6103 of the AML Act formalizes the "FinCEN Exchange," first launched in 2017 as a mechanism to facilitate public-private information sharing on BSA and other AML issues among law enforcement agencies, national security agencies, financial institutions and FinCEN. The goal of the FinCEN Exchange is to more effectively combat threats posed by money laundering, terrorism financing, and other financial crimes. Information shared under the FinCEN Exchange is required to be protected in a manner to ensure appropriate confidentiality of personal information.

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[7] For further information about the *Kokesh* decision, please refer to *Dechert OnPoint*, The Supreme Court Affirms, But Limits, The SEC's Disgorgement Authority.

Financial institutions are permitted to use information in the FinCEN Exchange only for purposes of identifying and reporting activities that may involve money laundering or the financing of terrorism or other financial crimes, but not for other purposes.

Other Coordination Efforts

The AML Act includes several additional enhancements intended to facilitate the coordination of AML efforts, including by:

- Requiring the appointment of BSA Information Security Officers within FinCEN, the Internal Revenue Service, and federal functional regulators;
- Establishing an Office of Domestic Liaison within FinCEN, with U.S. regional liaisons responsible for conducting outreach to, and communication among, financial institutions and state and federal regulators; and
- Emphasizing the importance of regular communication by the FinCEN Director with federal functional regulators, financial institutions and state banking supervisors.

Conclusion

The AML Act makes several significant changes to the U.S. AML regime. Financial institutions and investment funds that are subject to BSA requirements, as well as other entities that have implemented AML compliance programs, should carefully assess the impact of these changes on their current activities.

This update was authored by:

Thomas C. Bogle
Partner
Washington, D.C.
+1 202 261 3360
thomas.bogle@dechert.com

Christopher D. Christian
Partner
Boston
+1 617 728 7173
christopher.christian@dechert.com

Darshak S. Dholakia
Partner
Washington, D.C.
+1 202 261 3467
darshak.dholakia@dechert.com

Michael J. Gilbert
Partner
New York
+1 212 698 3886
michael.gilbert@dechert.com

Jeremy B. Zucker
Partner
Washington, D.C.
+1 202 261 3322
jeremy.zucker@dechert.com

Robert J. Rhatigan
Associate
Washington, D.C.
+1 202 261 3329
robert.rhatigan@dechert.com

Mariel Bronen
Associate
New York
+1 212 698 3617
mariel.bronen@dechert.com