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I. INTRODUCTION

Over the years since its initial passage in 1970, the Bank Secrecy Act ("BSA")[1] has been transformed and adapted to combat the changing face of global terrorism and keep pace with new developments in money laundering.[2] BSA and Anti-Money Laundering ("AML") regulations impose standards aimed at preventing financial crimes by limiting the ability of criminals to co-opt financial institutions[3] in their criminal activity.[4] These regulations are necessary with today's high threat of terrorism and the potential use of financial institutions to fund such activity.[5] In the wake of September 11, 2001, the USA PATRIOT Act ("PATRIOT Act") was passed, amending the BSA, with the purpose of deterring and punishing terrorism throughout the world.[6] A major theme

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1. Currency and Foreign Trade Transaction Reporting Act of 1970 ("Bank Secrecy Act"), Pub. L. No.91–508, 84 Stat. 1118 (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.) (2012).

2. FED. FIN. INSTS. EXAMINATION COUNCIL, BANK SECRECY ACT/ ANTI-MONEY LAUNDERING EXAMINATION MANUAL 3–4 (2014).

3. For the purposes of this Note, financial institutions shall include: "(i) Banks; (ii) brokers or dealers in securities; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers in commodities." Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45152 n.6 (Aug. 4, 2014) (to be codified at 31 C.F.R Pts. 1010, 1020, 1023, 1024, and 1026) (defining the scope of financial institutions that will be subject to the additional customer due diligence requirements).

4. Bank Secrecy Act § 121, 12 U.S.C. § 1951; 31 C.F.R. §§ 1010.100(e), 1010.610 (2015); *Combating Transnational Organized Crime: Int'l Money Laundering as a Threat to Our Fin. System, Before the Subcomm. on Crime, Terrorism, and Homeland Security of the H. Comm. on the Judiciary*, 112th Cong. 16 (2012) (statement of Jennifer Shasky Calvery, Chief Asset Forfeiture and Money Laundering Section, Criminal Division, U.S. Dep't. of Justice) [hereinafter *Combating Transnational Organized Crime*]. BSA/AML regulations set compliance program standards to prevent crimes such as money laundering from occurring by requiring "at a minimum— (A) the development of internal policies, procedures, and controls; (B) the designation of a compliance officer; (C) an ongoing employee training program; and (D) an independent audit function to test programs." Bank Secrecy Act §205, 31 U.S.C. § 5318(h).

5. *Combating Transnational Organized Crime*, *supra* note 4, at 16.

6. Mark E. Plotkin & B.J. Sanford, *The Customer's View of "Know Your Customer"—Section 326 of the USA Patriot Act*, 1 BLOOMBERG CORP. L. J. 670, 670–71 (2006).

of the PATRIOT Act is the Know Your Customer ("KYC") idea for financial institutions.[7] The PATRIOT Act enforces the KYC concept by requiring financial institutions to implement customer identification programs ("CIP") as part of their BSA/AML compliance programs so that financial institutions know to whom they are lending and for whom they are holding money.[8]

FinCEN's[9] Notice of Proposed Rulemaking on Customer Due Diligence (the "NPRM"), which was introduced in August of 2014, continues the evolution of BSA/AML regulations.[10] With the NPRM, FinCEN intends to further the BSA's fundamental goals of promoting transparency and protecting the financial system from abuse and fraud.[11] The beneficial ownership requirement introduced in the NPRM expands current KYC regulations by requiring financial institutions to identify the beneficial owners of legal entity customer accounts.[12] The additional regulations that FinCEN has proposed come at a hefty price tag; according to FinCEN's Regulatory Impact Assessment ("RIA"), the additional Customer Due Diligence ("CDD") requirements will cost financial institutions between $700 million and $1.5 billion.[13] FinCEN has proposed the beneficial ownership requirement to address the issue of accounts being opened by legal entity customers with the purpose of avoiding disclosure of the beneficial owner of the account—actions that are being used to hide the identity of terrorists and drug smugglers among other bad actors.[14] While the PATRIOT Act has already addressed beneficial ownership, it does so only in two situations: for owners of

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7. *Id.* at 670

8. *Id*. at 674.

9. FinCEN derives its authority to "implement, administer and enforce compliance with the BSA" from the Secretary of the Treasury. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45152 (Aug. 4, 2014) (to be codified at 31 C.F.R Pts. 1010, 1020, 1023, 1024, and 1026).

10. *Id.* An Advance Notice of Proposed Rulemaking ("ANPRM") preceded the Notice of Proposed Rulemaking in 2012. Customer Due Diligence Requirements for Financial Institutions, 77 Fed. Reg. 13046 (Mar. 5, 2012).

11. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45152.

12. *Id.* at 45155–56.

13. FIN. CRIMES ENFORCEMENT NETWORK, U.S. DEP'T OF THE TREASURY, REGULATORY IMPACT ASSESSMENT FOR FINCEN NOTICE OF PROPOSED RULEMAKING: "CUSTOMER DUE DILIGENCE REQUIREMENTS FOR FINANCIAL INSTITUTIONS." 6 (2015) [hereinafter REGULATORY IMPACT ASSESSMENT] (estimating the 10-year quantifiable cost range).

14. *See* Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45152 (listing examples).

private banking accounts; and for correspondent accounts for certain foreign financial institutions.[15] This Note analyzes the NPRM and its commentary, delves into the implications that the additional CDD requirements will have on financial institutions as they attempt to implement them, and offers predictions and recommendations for the final rule.

This Note proceeds in four parts. Part II provides an overview of the beneficial ownership requirement for legal entity customers.[16] Part III analyzes the beneficial ownership requirement including specific issues regarding the rule, implications of the rule, and recommendations for how the final rule might be shaped to address the prior issues.[17] Lastly, Part IV concludes by assessing the effectiveness of the rule.[18]

II. OVERVIEW OF THE BENEFICIAL OWNERSHIP REQUIREMENT FOR LEGAL ENTITY CUSTOMERS

In 2010, FinCEN released guidance on beneficial ownership, describing it as "[t]he cornerstone of a strong . . . BSA/AML compliance program,"[19] leading to an Advanced Notice of Proposed Rulemaking ("ANPRM") in 2012.[20] The ANPRM led to the NPRM that was released in August of 2014,[21] the costs of which FinCEN estimated in late 2015.[22] FinCEN's NPRM is an attempt to further the U.S. Department of the Treasury's collaboration with the Financial Action Task Force ("FATF")[23] and the Group of Twenty Finance Ministers and Central Bank Governors to safeguard the financial system, increase financial

15. Currency and Foreign Trade Transaction Reporting Act of 1970 ("Bank Secrecy Act"), §205, 31 U.S.C. § 5318(h) (2012); 31 C.F.R. §§ 1010.620(b)(1), -.630 (2015) (applying to private accounts and correspondent foreign accounts respectively).

16. *See infra* Part II.

17. *See infra* Part III.

18. *See infra* Part IV.

19. FIN. CRIMES ENFORCEMENT NETWORK, U.S. DEP'T OF THE TREASURY, GUIDANCE ON OBTAINING AND RETAINING BENEFICIAL OWNERSHIP INFORMATION 1 (2010).

20. Customer Due Diligence Requirements for Financial Institutions, 77 Fed. Reg. 13046 (Mar. 5, 2012).

21. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).

22. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 2.

23. FATF is an "inter-governmental body" created to set forth international standards to protect the international financial system from "money laundering and the financing of terrorism and proliferation of weapons of mass destruction." *Who We Are,* FIN. ACTION TASK FORCE, http://www.fatf-gafi.org/about/ (last visited Nov. 14, 2015).

transparency, and to strengthen CDD requirements within the United States and throughout the world.[24] FinCEN's NPRM addresses four areas of CDD compliance and sets minimum CDD measures for financial institutions to implement in each area:

> 1. Identifying and verifying the identity of customers;
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> 2. Identifying and verifying the identity of beneficial owners of legal entity customers;
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> 3. Understanding the nature and purpose of customer relationships; and
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> 4. Conducting ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions.[25]

Areas 1, 3, and 4 are required under current BSA/AML requirements, but were included in the NPRM to clarify the current state of CDD requirements.[26] The only new requirement introduced by the NPRM is the second area, "identifying and verifying the identity of beneficial owners of legal entity customers"[27] (the "Beneficial Ownership Requirement").[28]

FinCEN breaks the Beneficial Ownership Requirement down into two prongs for compliance purposes:

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24. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45155.

25. *Id.* (reformatted block quote).

26. *Id.* at 45155–56.

27. "A 'legal entity' customer is generally any business enterprise with a few exceptions." PETER G. WEINSTOCK, ET AL., HUNTON & WILLIAMS, CLIENT ALERT: FINCEN EXPANDS CUSTOMER DUE DILIGENCE REQUIREMENTS 3 (2014), https://www.hunton.com/files/News/2ef7f567-8636-457b-9536-8dd8fc7ea81d/Presentation/NewsAttachment/e0ec2f9f-d3fa-426c-b25a-8f170e7e7e0e/FinCEN_Expands_Customer_Due_Diligence_Requirements.pdf. "These exemptions include any customers that are currently exempt from CIP, as well as parties whose beneficial ownership information is generally available to the public from other sources such as public companies registered with the SEC." *Id.* (footnote omitted).

28. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45152, 45156.

- Ownership Prong: Each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25% or more of the equity interests of a legal entity customer; and
- Control Prong: An individual with significant responsibility to control, manage or direct a legal entity customer, including (A) an executive officer or senior manager (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, a General Partner, President, Vice President, or Treasurer); or (B) any other individual who regularly performs similar functions.[29]

With the addition of the Beneficial Ownership Requirement, financial institutions will now be required to identify the beneficial owners for a much wider array of accounts.[30] Once the final rule has been released, financial institutions will be forced to implement the new beneficial ownership requirement within one year, allowing FinCEN to further enable financial institutions to identify and assess risks, and assist law enforcement in financial investigations.[31]

The Federal Trade Commission's ("FTC") comment letter to the NPRM provides examples of how the new Beneficial Ownership Requirement could have aided law enforcement are discussed in the following text.[32] In one case, money mules were used to set up bank accounts and then preceded to funnel the profits to the true beneficial owners who were overseas.[33] Had the new Beneficial Ownership Requirement been in place the FTC could have quickly initiated an investigation into the overseas party, who would have been required to

29. *Id.* at 45157; WEINSTOCK, ET AL., *supra* note 27, at 2 (footnote omitted).

30. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45157.

31. *Id.* at 45153, 45164.

32. Comment letter from Jessica L. Rich, Dir. Bureau of Consumer Prot., & Michael G. Vita, Acting Dir. Bureau of Econ., Fed. Trade Comm'n, to Fin. Crimes Enf't Network 4 (Oct. 3, 2014) [hereinafter Rich & Vita Letter], http://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0119.

33. *Id.*

be disclosed in order for the money mules to set up the bank accounts.[34] FinCEN says that even if the representations of legal entity customers were false, law enforcement would at least have a lead on where to start a search.[35] More importantly, FinCEN notes that the requirements will significantly deter nominee assignments since the natural person listed as the nominee would be risking criminal prosecution.[36] The FTC says the new Beneficial Ownership Requirement would have also aided them in determining the beneficial owners of a series of shell companies created to hide illegal online poker proceeds payment processing.[37] The FTC claims that had the Beneficial Ownership Requirements had been in place, the dozens of shell companies created by nominees of the defendant would have had to list the defendant as the actual beneficial owner.[38] Had the actual beneficial owner been listed, the vast number of accounts created for the defendant would have triggered suspicions, and the FTC would have known whom to investigate.[39]

III. ANALYSIS OF THE BENEFICIAL OWNERSHIP REQUIREMENT AS IT APPLIES TO LEGAL ENTITY CUSTOMERS

While the intentions and purpose of the Beneficial Ownership Requirement seem to be advantageous, several portions of the proposed rule are ineffective and give rise to specific issues and unintended consequences.[40] Even when there is not a control person, financial institutions will still be required to identify one.[41] FinCEN states that financial institutions will not be required to "verify that the natural persons identified on the form [that is filled out by the legal entity customer] are in fact the beneficial owners."[42] Rather than verify

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34. *Id.* at 3.

35. Customer Due Diligence Requirements for Financial Institutions,79 Fed. Reg. at 45162; Rich & Vita Letter, *supra* note 32, at 4.

36. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 30.

37. Rich & Vita Letter, *supra* note 32, at 4.

38. *Id.*

39. *Id.*

40. Comment letter from Senator Carl Levin, Chairman, U.S. Permanent Subcomm. on Investigations, to Fin. Crimes Enf't Network 2 (Dec. 10, 2014) [hereinafter Levin Letter], http://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0141.

41. WEINSTOCK, ET AL., *supra* note 27, at 2.

42. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45156 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).

beneficial ownership information, financial institutions will be allowed to rely on the information provided to them by the legal entity customer when it opens an account.[43] FinCEN and the FTC claim that the additional information, even when false, will still be valuable to law enforcement agencies.[44] The American Bankers Association and the Bankers Association for Finance and Trade[45] (the "Associations") state that "the marginal benefits to law enforcement are in considerable doubt."[46] This doubt is barely addressed by FinCEN in its RIA.[47] FinCEN, rather, lists other beneficial motives for the regulation such as reputational benefits to the U.S. Government and "Potential Increased Revenue through Improved Tax Compliance."[48] Under the NPRM, financial institutions will not be required to retroactively apply the Beneficial Ownership Requirements to old accounts, only to accounts opened a year after the final rule is released.[49] Additionally, while financial institutions are not required to update beneficial ownership information on a set schedule, FinCEN has stated that financial institutions "should" periodically monitor accounts and update beneficial ownership information on a risk basis.[50]

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43. *Id.* at 45158. FinCEN postures that even if the information that is reported to them is false, or if there is not a control person, by having the legal entity customer report a natural person, law enforcement will be benefited by having information which can prove "unlawful intent and . . . generate[] leads to identify additional evidence or co-conspirators." *Id.* at 45153.

44. *Id.* at 45162; Rich & Vita Letter, *supra* note 32, at 4.

45. "BAFT is the leading international transactional banking association . . . [f]ormed by the merger of the Bankers Association for Finance and Trade (BAFT) and the International Financial Services Association (IFSA)." *Who We Are*, BAFT, http://www.baft.org/about-baft (last visited Nov. 14, 2015).

46. Comment letter from Robert G. Rowe III, Vice President & Assoc. Chief Counsel, Regulatory Compliance, Am. Bankers Ass'n, & Tod R. Burwell, President & Chief Exec. Officer, BAFT, to Fin. Crimes Enf't Network 26 (Oct. 3 2014) [hereinafter Rowe & Burwell Letter], http://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0133.

47. *See* REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 30.

48. *Id.* at 18–19.

49. SULLIVAN & CROMWELL LLP, CLIENT ALERT: 2014 YEAR-END REVIEW OF U.S. BSA/AML AND SANCTIONS DEVELOPMENTS AND THEIR IMPORTANCE TO FINANCIAL INSTITUTIONS 18 (2015) https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2014_Year_End_Review_of_US_BSA_AML_and_Sanctions_Developments.pdf.

50. Rather than requiring financial institutions to periodically update Beneficial Ownership information FinCEN dictates that "when a financial institution becomes aware of information relevant to assessing the risk posed by a customer, it is expected to update the customer's relevant information accordingly." WEINSTOCK, ET AL., *supra* note 27, at 4.

A. Specific Issues Raised During the Comment Period

The main issues identified in the extensive comments to the NPRM are: (1) the definition of a legal entity customer and the exemptions from the definition; (2) the ownership prong of the beneficial ownership definition; (3) the control prong of the beneficial ownership definition; (4) verification; (5) monitoring; (6) application to new accounts only; and (7) the delayed effective date.

1. Definition of a Legal Entity and the Exemptions from the Definition

Commentary to the NPRM raised the question of what the actual definition of a legal entity customer is and what truly falls under the reporting exceptions.[51] The NPRM did not consider joint ventures, international accounts, PACs, or series LLCs, any of which could be considered a legal entity customer but are not defined as such in the NPRM.[52] In the NPRM, FinCEN states that most trusts are not included in the definition of a legal entity customer because, due to the contractual nature of a trust, financial institutions already have the trustee's information on hand in the event it is needed by law enforcement.[53] The Clearing House Association ("TCH") suggests private trusts should have a specific exemption in the final rule to provide even more clarification.[54] In addition to clarification on specific types of entities, TCH advocates for FinCEN to adopt a comprehensive definition of what a legal entity encompasses and to broaden the exemptions to the definition.[55]

According to TCH, the definition of a legal entity customer under the NPRM is only focused on U.S.-based clients.[56] In order to provide an effective definition for the final rule, TCH proposes that FinCEN adopt

51. Comment letter from Ruben Villa, Peoples State Bank, to Fin. Crimes Enf't Network. 2 (Sept. 17, 2014) [hereinafter Villas Letter], http://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0028.

52. *Id.*

53. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45159–60 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).

54. Comment letter from Alaina M. Gimbert, Senior Vice President & Assoc. Gen. Council, The Clearing House Ass'n, to Fin. Crimes Enf't Network 10 (Oct. 3, 2014) [hereinafter Gimbert Letter], http://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0093.

55. *Id.* at 9.

56. *Id.*

a comprehensive definition of a legal entity by including entities that are registered under equivalent foreign laws.[57] In addition, TCH notes that the NPRM does not grant exemptions for bank holding companies, financial holding companies, or financial market utilities, all of which are low risk and are already subject to extensive regulatory oversight.[58]

Rather than the rule having an all-encompassing definition with a slim set of exemptions, TCH urges a broader set of exemptions, determined on a risk basis, be adopted.[59] By assessing the risk a legal entity customer poses and using that as a filter to determine which customers should be covered under the CDD requirements, the vast amount of reporting by financial institutions could be minimized.[60] The Associations point out that if a risk-based approach is adopted and the exemptions expanded, then the regulation would allow for financial institutions to collect relevant data rather than complying with a "merely ministerial collection requirement."[61] By expanding the exemptions, FinCEN would be able to better address the legal entity customers that are the focus of the new regulation and not subject innocent entities to the costs and burdens of the new rule.[62]

2. The Ownership Prong of the Beneficial Ownership Definition

FinCEN, in the ownership prong of the Beneficial Ownership Requirement, has set a 25% threshold to identify "key individuals" who have a substantial interest in the legal entity.[63] Chairman of the Permanent Subcommittee on Investigations Senator Carl Levin[64] questions the 25% threshold under the ownership prong of the beneficial ownership requirement, claiming it is too high and will result in a lack of

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57. *Id.*

58. *Id.* at 10.

59. *Id.* at 9–10.

60. Rowe & Burwell, *supra* note 46, at 6–7.

61. *Id.* at 11.

62. *See* Gimbert Letter, *supra* note 54, at 10–13.

63. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg., 45151, 45158 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).

64. Senator Levin did not seek reelection in 2014 and retired shortly after he penned his commentary to the NPRM. David Shepardson, *Carl Levin: No Regrets on Retiring, Hails Peters Win*, THE DETROIT NEWS, (Nov. 4, 2014, 10:54 PM), http://www.detroitnews.com/story/news/politics/elections/2014/11/04/carl-levin-regrets-retiring-hails-peters-win/18507435/.

reporting from bad actors.[65] Senator Levin believes disclosure thresholds are "generally an ineffective approach."[66] Disclosure thresholds can easily be avoided by bad actors rearranging their legal entity so ownership percentages are lower than the threshold.[67] If a legal entity wanted to engage in unlawful actions and avoid putting forth any key beneficial owners under the ownership prong, the obvious loophole is for the entity to have five or more people serving as equity owners and thus avoid reporting.[68] Furthermore, Senator Levin believes that a 25% threshold is inadequate because Congress has already established a 10% threshold for substantial ownership of a corporation under the Foreign Account Tax Compliance Act ("FATCA").[69] Not only does the 25% threshold create a weaker standard than those already in place elsewhere, it incentivizes bad actors to exploit the differentiation between accounts[70] and take advantage of the weaker disclosure threshold.[71]

Contrary to Levin, the Associations advocate for leaving the threshold at 25%.[72] The Associations note that the 10% threshold is in place for "*enhanced* due diligence," rather than for regular CDD, such as the beneficial ownership rule.[73] The Associations have also requested that the final rule explicitly state that financial institutions are not required to determine why a customer's account does not have any owners who meet the 25% threshold, resulting in a lack of reporting.[74] The Associations urge FinCEN to first determine why the 25% threshold is not adequate before abandoning it and creating an even stricter

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65. Levin Letter, *supra* note 40, at 3.

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* The Foreign Account Tax Compliance Act focuses on reporting by U.S. taxpayers of "foreign financial accounts and offshore assets" and imposes withholdings for non-compliance. INTERNAL REVENUE SERV., *Foreign Account Tax Compliance Act*, https://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA (last updated July 15, 2015); 26 U.S.C. § 1473(2)(A) (2012).

70. Exploitation could occur through bad actors choosing to create an account that is subject to the 25% threshold as opposed to the 10% threshold by having a nominee set up the account. Levin Letter, *supra* note 40, at 3–4.

71. *Id.*

72. Rowe & Burwell Letter, *supra* note 46, at 9–10.

73. *Id.*

74. *Id.* The Associations worry about being required to determine if the legal entity customer is actually at the 25% threshold due to the difficulty for a financial institution to ascertain whether such statements are correct. *Id.*

regulation.[75] After all, the 25% threshold is based upon extensive comments to the ANPRM.[76]

FinCEN agrees with the Associations concerning a 10% threshold, and in its RIA addresses that proposition, along with several other alternatives to the 25% threshold.[77] FinCEN notes that, while a 10% requirement would provide more information to law enforcement, it would "predominantly impact legitimate legal entities, and impose upon them a significant burden that would not be outweighed by the incremental benefit to law enforcement."[78]

FinCEN also raised the alternative in its RIA of applying the 25% threshold to both existing and new accounts.[79] FinCEN posits that such a change will be exceedingly beneficial while incurring little additional IT costs due to the development that will need to take place for the changes.[80] This alternative is noteworthy, however, since requiring financial institutions to retroactively determine beneficial ownership status directly disregards the majority of comments issued relating to the final rule.[81] FinCEN has recognized that retroactive application of the requirements will mean additional work for financial institutions and will extend the compliance deadline appropriately.[82]

3. The Control Prong of the Beneficial Ownership Definition

The definition of a control person under the Beneficial Ownership Requirement is "a single individual with significant responsibility to control, manage, or direct a legal entity customer, including (i) An executive officer or senior manager . . . ; or (ii) Any other individual who regularly performs similar functions."[83] This definition of a control person differs from the standard proposed by FATF of "'incorporat[ing]

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75. *Id.* at 9.
76. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45158 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).
77. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 9.
78. *Id.*
79. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 10.
80. *Id.*
81. *See* Rowe & Burwell Letter, *supra* note 46, at 11–12.
82. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 9–10.
83. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45170 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).

those persons who exercise *ultimate effective control* over a legal person or arrangement.'"[84] According to Senator Levin, the proposed rule focuses on officers who do not exercise actual control of a company and rather, are placed in their positions to hide the true directors of the company.[85] FinCEN has set forth the control prong to embody international standards by requiring financial institutions to determine who has control of a legal entity customer, however, the proposed rule falls short, according to Senator Levin, by not encompassing those who have "ultimate effective control".[86]

Requiring a financial institution to identify owners who have ultimate effective control would be difficult to implement.[87] Further, if included in the current rule, the additional requirement would prove moot since financial institutions are allowed to rely upon the representations of legal entity customers.[88] Extensive industry requests have been made regarding the final rule to ensure financial institutions do not have to verify control status.[89] Financial institutions contend they "lack [the] ability to verify the status of an individual as a beneficial owner."[90] Thus, a final rule requiring financial institutions to verify if a control person maintains ultimate effective control would be ineffective—unless the rule was made even more overbearing and required verification—since there is no structure in place for a financial institution to determine if the initial designation of a control person is valid.[91]

4. Verification and Monitoring

The NPRM allows financial institutions to rely on representations made by legal entity customers, thereby reducing the regulatory burden

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84. Levin Letter, *supra* note 40, at 5 (alteration in original) (emphasis added).

85. *See id.* at 4–6.

86. Senator Levin seems to be concerned with the new rule not having an actual effect due to the ability of bad actors to provide false information at will, a topic that the Associations also bring up but in a different context by questioning the true benefit of false information to law enforcement. *See* Levin Letter, *supra* note 40, at 3–4.

87. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45171.

88. *Id.* at 45170.

89. Rowe & Burwell Letter, *supra* note 46, at 8–9.

90. *Id.* at 8–9, 12.

91. *Id.*

of the proposed rule.[92] Financial institutions do not have to verify that the people named as beneficial owners truly are the beneficial owners.[93] This designation would seem to allow bad actors to designate false beneficial owners, but FinCEN (in the NPRM) and the FTC (in its comment to the NPRM) noted "[e]ven false information provided to financial institutions can be useful to prove an individual's knowledge of unlawful activity or intention to conceal assets."[94] In the FTC's comment to the NPRM it discusses cases where the beneficial ownership information would have been helpful, even if the information were false.[95] However, the Associations have questioned the extent to which false information will be beneficial to law enforcement.[96]

The Associations argue financial institutions should not be responsible for verifying the designations by the legal entity customers.[97] They are concerned about the immense compliance burden that would be created if FinCEN were to require financial institutions to investigate complex businesses and their ownership structures.[98] Implementing a verification requirement is also cautioned against by the Associations because of its potential to be so detrimental as to "drive businesses underground or off-shore."[99] Disagreeing with the Associations, FinCEN in its RIA, claims that the rule would be "unlikely to trigger legitimate account holder closings or to dissuade legitimate would-be new account holders from opening new accounts."[100] The American Bankers Association ("ABA") cautions FinCEN's optimism, claiming FinCEN's opinion on account loss "is the triumph of hope over experience, a poor foundation for rulemaking."[101] The modern financial atmosphere,

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92. *See* Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45156.

93. *Id.* at 45162; SULLIVAN & CROMWELL LLP, *supra* note 49, at 18.

94. Rich & Vita Letter, *supra* note 32, at 4; Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. at 45153.

95. Rich & Vita Letter, *supra* note 32, at 4.

96. Rowe & Burwell Letter, *supra* note 46, at 26.

97. *Id.* at 10–11.

98. *Id.* at 10.

99. The Associations worry that the increased cost of doing business under the NPRM will force businesses to use other sources of financing such as overseas financial institutions or P2P institutions not affected by the NPRM. *See id.* at 10.

100. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 26.

101. Comment letter from Robert G. Rowe III, Vice President & Assoc. Chief Counsel, Regulatory Compliance, Am. Bankers Ass'n, to Fin. Crimes Enf't Network 13 (Jan. 27 2016) [hereinafter Rowe, RIA Letter],

coupled with "the increased risk from incomplete or questionable information on beneficial ownership will cause lost accounts from legitimate customers."[102] Given the need for reasonable procedures, the NPRM's current permission for financial institutions to rely upon self-identification by legal entity customers should carry over into the final rule.[103]

5. Monitoring

Except that the additional CDD applies to accounts opened one year after the final rule is enacted, there is little guidance in the NPRM for ongoing monitoring after the initial designations are made.[104] The NPRM asserts, "periodic. . .monitoring" of CDD information must be performed by financial institutions, but how frequent and thorough the periodic monitoring must be is unclear.[105] FinCEN, in its commentary to the NPRM, states that while additional monitoring is not required, "as a general matter, a financial institution should keep . . . beneficial ownership information, as current as possible and update as appropriate on a risk-basis."[106] An open question is whether financial institutions will be required to complete additional monitoring and file Suspicious Activity Reports ("SAR") when a business mistakenly identifies the incorrect control person.[107] Or, additionally, whether the filing of such a SAR will trigger an update of CDD information.[108] Given the extensive number of accounts financial institutions will have to report on as well as the number of errors made by legal entity customers, especially smaller,

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http://www.aba.com/Advocacy/commentletters/Documents/cl-FinCEN-RIA-IRFA2016.pdf.

102. *Id.*

103. *Id.* at 11.

104. *See* WEINSTOCK, ET AL., *supra* note 27, at 4.

105. *Id.* at 4.

106. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151, 45162 (Aug. 4, 2014) (to be codified at 31 C.F.R. Pts. 1010, 1020, 1023, 1024, and 1026).

107. The NPRM leaves open the proposition that financial institutions "*should update*" beneficial ownership information, which the Associations label as "the epitome of the type of vague expectation that leads to 'understood best practices' which in turn causes examiners and auditors to second guess what a financial institution is doing, eventually producing check-the-box compliance." Rowe & Burwell Letter, *supra* note 46, at 18.

108. Other than through normal business operations, financial institutions would be unlikely to determine such information. However, when such a mistake is brought to light, will a financial institution be required to file with FinCEN when the legal entity customer does not appear to be a risky entity? Villa Letter, *supra* note 51, at 2.

less sophisticated entities, the additional monitoring will prove burdensome.[109] By creating an overly burdensome system requiring extended monitoring and reporting with potential fines for financial institutions' non-compliance, FinCEN risks making credit or bank services unavailable to uninformed legal entity customers.[110]

6. Application to New Accounts Only

Industry associations are worried that FinCEN will reverse its decision as to the retroactive reach of the proposed rule in its final installment.[111] Current CIP procedures do not require financial institutions to validate the identity of covered customers.[112] To identify the beneficial owners of older accounts, financial institutions will have to go deeper in their CIP process and implement a much more complex system than that which is currently in place.[113] CIP expansion is mitigated under the NPRM because, in its current state, financial institutions would not have to retroactively identify the beneficial owners of accounts opened before the rule takes effect.[114] Since there are no systems in place and creating such systems would bear high costs without providing sufficient value,[115] financial institutions "strongly believe that the requirement to obtain beneficial owner information should [continue to] be limited to new accounts only."[116]

FinCEN, however, in its RIA, has already brought the possibility of a retroactive final rule into play.[117] The RIA does not address concerns over the costs of the final rule if it is not limited to new accounts, outside of the potential for an extended compliance date.[118] On the one hand,

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109. *Id.* at 3–4.

110. *Id.* at 3.

111. Rowe & Burwell Letter, *supra* note 46, at 11–12; *see also* Villa Letter, *supra* note 51, at 3 (claiming that the retroactive approach to the beneficial ownership requirement would present an "insurmountable obstacle" to financial institutions).

112. Villa Letter, *supra* note 51, at 3.

113. *Id.*

114. *Id.*

115. *See* Rowe & Burwell Letter, *supra* note 46, at 11–12.

116. Comment letter from James R. Richards, EVP BSA Compliance Officer, Wells Fargo & Company, to Fin. Crimes Enf't Network. 3 (Oct. 2, 2014) [hereinafter Richards Letter], http://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0077. *See* Villa, *supra* note 51, at 3.

117. *See supra* Part III.A.2; REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 9-10.

118. *See* REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 10.

FinCEN's desire to be thorough and implement as strong of a rule as possible by retroactively applying the 25% threshold makes sense.[119] On the other hand, FinCEN does not consider that "existing customers already have an established history with the financial institution and an established track record of minimal or effectively managed risk."[120] While the retroactive application of the rule may be beneficial to a certain extent, given the comments from the NPRM, it seems additional analysis should be undertaken before this particular alternative is incorporated.[121]

7. Delayed Effective Date

Many commenters on the NPRM were dissatisfied with FinCEN's proposal that full compliance with the CDD requirements take place one year after the final rule takes effect.[122] The Associations estimate the task of updating the necessary technology systems will take financial institutions at least eighteen months, but caution that it may take longer.[123] The majority of commenters asked for at least a twenty-four month period to transition to full compliance.[124] The twenty-four month period may need to be extended based upon the changes made between the NPRM and the final rule.[125] The reason for requesting the extension is clear—compliance with yet another BSA/AML requirement will take time, especially for financial institutions that already fail to meet current requirements.[126] Another reason for needing additional time is the lack of personnel to implement the extensive technology systems overhaul that the proposed rule will require.[127] In all, FinCEN's one-year

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119. *Id.*

120. Rowe & Burwell Letter, *supra* note 46, at 11–12.

121. *See id.*

122. *Id.*; Richards Letter, *supra* note 116, at 2; Villa Letter, *supra* note 51, at 3–4.

123. Rowe & Burwell Letter, *supra* note 46, at 20–21.

124. *Id.*; Gimbert Letter, *supra* note 54, at 15; Richards Letter, *supra* note 116, at 2; Villa Letter, *supra* note 51, at 3–4.

125. Rowe & Burwell Letter, *supra* note 46, at 20–21; Gimbert Letter, *supra* note 54, at 15; Richards Letter, *supra* note 116, at 2; Villa Letter, *supra* note 51, at 3-4.

126. The Bank of Mingo assessment is an example of a case in which a smaller financial institution systemically failed in implementing even minimum current BSA/AML standards. In the Matter of Bank of Mingo, FIN. CRIMES ENFORCEMENT NETWORK, U.S. DEP'T OF THE TREASURY, (Jun 15, 2015) (Assessment of Civil Money Penalty) at 2–3.

127. The Associations note that this regulation will be tough to implement due to the limited availability of "qualified programmers." Rowe & Burwell Letter, *supra* note 46, at 21.

compliance period is beyond optimistic and unrealistic according to the majority of commenters.[128]

B. *Implications of the Additional CDD Requirements*

The goal of the proposed CDD regulations is to "reduce illicit activity by providing easier access to beneficial ownership information to support law enforcement investigations."[129] The downside of the new regulations, however, is the vast costs associated with the proposed rule and the difficulty in calculating hard numbers to quantify the rule's benefits.[130] According to FinCEN, the quantitative costs of the CDD rule will be anywhere between $700 million and $1.5 billion over a period of ten years, with most of the costs being front-loaded.[131] FinCEN does admit that their figure is lacking in one major unquantifiable cost—the cost of IT upgrades.[132] Though unquantifiable, in their RIA FinCEN assigns necessary IT upgrades an "improbably large" upper boundary of $10 billion.[133] Even if the IT costs come with a price tag that is one tenth of the "improbably large"[134] upper boundary, the costs of implementing the final rule could easily double.[135] Considering FinCEN's research, in which one small financial institution estimated IT expenditures of fifty to seventy thousand dollars and one large institution estimated IT upgrades of $20 million, IT costs could easily rise above $2 billion.[136]

FinCEN's RIA has been challenged as failing to comply with the administrative process[137] due to the RIA "significantly overstat[ing] the perceived benefits of the proposed CDD rule while underestimating, or

128. *Id.*; Gimbert Letter, *supra* note 55, at 15; Richards Letter, *supra* note 116, at 2; Villa Letter, *supra* note 51, at 3–4.

129. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 6.

130. *Id.* at 7–9.

131. *Id.* at 6.

132. *Id.* at 32.

133. FinCEN was unable to gain a large enough sample size to definitively assign a cost to the IT upgrades. With FinCEN approximating that 28,816 financial institutions will be required to make the necessary IT upgrades the ease with which cost can reach into the billions is put into context. *Id.* at 32–33, 33 n.64.

134. *Id.* at 33.

135. *Id.* at 32–33.

136. *Id.* at 33 n. 64.

137. Rowe, RIA Letter, *supra* note 101, at 6 (discussing how the RIA "[c]ontravene[s] the Regulatory Flexibility Act and Executive Orders 12866 and 13563 by failing to describe accurately the likely impact of the rule on private entities").

ignoring entirely, significant costs, and therefore fail[ing] to satisfy the statutory mandates."[138] The lack of quantitative costs, which was pointed out by the ABA in their comment letter to the RIA,[139] casts significant doubt upon the real cost of the regulation and its true benefit.[140] Considering that using FinCEN's calculations IT costs alone could easily double the anticipated price of the bill, and the high likelihood of the FinCEN's quantitative determinations being understated,[141] the potential for a rule, that has been touted as having quantifiable costs of at most $1.5 billion, ending with a multibillion dollar price tag is a sobering thought.

In addition to the costs of the proposed rule, Senator Levin questions the NPRM on the basis of it not strengthening or meeting the goals of the BSA/AML regulations because it does not encompass a wide enough array of beneficial owners."[142] Senator Levin goes so far as to claim the proposed rule would actually weaken current AML practices and the NPRM's focus on specific employee positions is a step away from international BSA/AML standards.[143] The IMF and FATF measured FinCEN's proposed rule and found it to be incongruent with FATF standards, which echoes the skepticism of Senator Levin.[144] By setting a 25% threshold under the ownership prong and an arbitrary designation for a control person, the proposed Beneficial Ownership Requirements fall short of protecting against fraud by leaving gaping loopholes for bad actors to avoid reporting.[145] FinCEN does not foresee criminals reducing their beneficial ownership percentage given the difficulties associated with laundering money through a vehicle in which they hold only a

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138. *Id.*

139. *Id.* at 10.

140. *See id.*

141. *Id.*

142. Levin Letter, *supra* note 40, at 8.

143. *Id.*; THE FIN. ACTION TASK FORCE, INT'L STANDARDS ON COMBATING MONEY LAUNDERING AND THE FIN. OF TERRORISM & PROLIFERATION—THE FATF RECOMMENDATIONS 109 (2012), http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

144. In its assessment of the United States and its Anti-Money Laundering efforts the International Monetary Fund notes the reliance on customer certification as a factor for why the NPRM is not fully in compliance with FATF standards and why the proposed rule does not completely address the control aspect of beneficial ownership. IMF, *Anti-Money Laundering and Combating the Fin. of Terrorism (AML/CFT)*, Technical Note 11 (Jul. 2015), https://www.imf.org/external/pubs/ft/scr/2015/cr15174.pdf.

145. Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45151 (Aug. 4, 2014) (to be codified at 31 CFR Parts 1010, 1020, 1023, 1024, and 1026).

minority stake.[146] FinCEN's projection, however, does not seem to take into consideration sophisticated criminal organizations who would have an organization sizeable enough that minority stake would not be an issue.[147]

C. Recommendations

Notwithstanding FinCEN's intentions to provide clarity to CDD requirements, the manner in which it has formulated the new beneficial ownership requirement has created a regulation that is ineffective and poses unjustifiable expenses upon financial institutions. In an attempt to set forth a feasible rule, the NPRM has been deemed to "weaken current AML practices"[148] by some commentators and to be "burdensome"[149] by others. While the additional CDD requirements might be a slight boon to enforcement agencies by giving them a starting point for their search, that boon is counteracted by the increased costs to law-abiding legal entity customers[150] and the potential for financial institutions to lose customers.[151] To reiterate Senator Levin and the vast majority of commenters on the NPRM, the proposed rule should not be adopted in its current form[152] because its potential benefits are outweighed by the unjustified burden it will have on legal entity customers and financial institutions.[153] FinCEN counters the unjustified-costs assertion with a break-even analysis in their impact assessment, determining the final rule will only need to reduce the volume of illicit activity by 0.57% in each of the next ten years.[154] Such a small increase may seem easy to achieve,

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146. *See* REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 16.

147. *See id.*

148. Levin Letter, *supra* note 40, at 8.

149. Rowe & Burwell Letter, *supra* note 46, at 21–22.

150. In its impact assessment FinCEN states that competition amongst financial institutions will limit the amount of the costs that can be passed on to the customers but given that the billions that financial institutions will be forced to expend it would only follow that at least a portion of that will be passed on to customers. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 8 n.9.

151. Rowe & Burwell Letter, *supra* note 46, at 25–26 (noting the CDD requirements may lead some customers to take their business overseas or underground).

152. FinCEN's impact assessment suggests three possible alternatives to the current rule, two of which they themselves expose the inefficiencies of and the third would only increase the costs associated with the current rule. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 9–10.

153. *Id.* at 25–26.

154. *Id.* at 11.

but the extent to which the Beneficial Ownership Requirement will affect the $300 billion in yearly illicit proceeds from money laundering is difficult to determine when there are "unquantifiable benefits and costs."[155]

Instead of requiring financial institutions to perform CDD and beneficial ownership analysis for the vast number of accounts that will be opened by currently covered legal entities, a risk-based approach[156] should instead be applied.[157] Additionally, the types of legal entities exempted from the rule should be expanded.[158] If a risk-based approach is adopted, the 25% threshold could be lowered, as Senator Levin suggests, without the overly burdensome outcome feared by the Associations.[159] FinCEN's alternative[160] of retroactively applying the Beneficial Ownership Requirements to previously opened accounts should not be implemented.[161] FinCEN, however could provide the largest benefit to law enforcement while minimizing the extensive costs to financial institutions and their customers by applying the rule retroactively only when a legal entity customer has engaged in suspicious activity and does not have a history of "minimal or effectively managed risk"[162] with the financial institution.

Finally, the question remains as to whether financial institutions are the best gatekeepers and collectors of such information.[163] Not only do financial institutions not create the legal entities for which they are being asked to provide information, but also they have no mandate to verify the legal entity's CDD information.[164] Financial institutions also do not have regulatory power over the legal entity customers FinCEN is requiring them to report on.[165] Senator Levin is concerned that the NPRM

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155. *Id.* at 30.

156. *See supra* Part III.1.

157. Gimbert Letter, *supra* note 53, at 12–13.

158. Rowe & Burwell Letter, *supra* note 46, at 6–8.

159. *See* Levin Letter, *supra* note 40, at 3–4 (stating that the threshold is to high); Rowe & Burwell Letter, *supra* note 46, at 9 (stating that by lowering the threshold the costs will rise).

160. REGULATORY IMPACT ASSESSMENT, *supra* note 13, at 9–10.

161. *See* Rowe & Burwell Letter, *supra* note 46, at 11–12 (discussing the unjustified costs of retroactive implementation).

162. *Id.*

163. *Id.* at 25.

164. *Id.*

165. *Id.*

is not up to par with international standards by not encompassing "ultimate effective control" in its definition of a control person.[166] Incorporating ultimate effective control however, would require financial institutions to verify legal entity customer information, which they are not in a position to do.[167] Alternatively, rather than requiring financial institutions to report on beneficial ownership, federal and state registries for such information could be maintained by the Internal Revenue Service because that agency is more likely to have access to the requisite information.[168]

IV. CONCLUSION

The Beneficial Ownership Requirement has many uncertainties surrounding it, the most prominent being its effectiveness, or rather lack of it. One certainty regarding the proposed rule, which is not a boon to FinCEN as they look to push the final rule into existence, is the exorbitant cost that will be withstood to comply with the rule. As the final rule is drafted and comes into effect, FinCEN would be well-served by taking into consideration the issues that have been raised in order to avoid an ineffective rule that will cost financial institutions and their customers billions of dollars.

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166. Levin Letter, *supra* note 40, at 5
167. Rowe & Burwell Letter, *supra* note 46, at 26.
168. *Id.*