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Congress Eyes Modernization of Bank Secrecy Act and Beneficial Ownership Disclosures

A significant and much needed update to the United States' anti-money laundering (AML) laws is one of the few remaining legislative efforts that may get across the finish line during this election year. Members of both parties on both sides of the Capitol recognize that the current AML system is inadequate to meet the evolving challenges presented by terrorist organizations, international drug and human traffickers, and domestic criminal enterprises. Disagreement about one key issue, however, appears to be holding up progress on reform legislation: how, when and to whom a company must disclose its beneficial owners. Resolution of the beneficial ownership issue could have significant impacts not only on financial institutions, which currently must collect the information, but also on businesses in all industries and of all sizes, especially those that prefer or find it necessary to transact with a degree of anonymity.

Current Law: The Bank Secrecy Act and the Customer Due Diligence Rule

The centerpiece of the Bank Secrecy Act is a financial institution's obligation to file "Suspicious Activity Reports" (SARs) and "Currency Transaction Reports" (CTRs) with the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department charged with coordinating an interagency effort to detect and combat money laundering. Presently, financial institutions file a CTR for each transaction over $10,000, regardless of whether the transaction is routine or out of the ordinary; they file a SAR for each transaction in excess of $5,000 that the bank, following its policies and procedures, concludes may be suspicious.[1]

The primary criticism of the current AML system from both the law enforcement and financial institution perspectives is that it is inefficient because BSA compliance is monitored by bank regulators who grade financial institutions based on how well they follow internal procedures, not on how valuable their information is to law enforcement. In 2017, depository institutions alone (other financial services companies, including money services businesses and securities brokers, are required to file SARs as well) spent billions of dollars on AML compliance and filed over 900,000 SARs with FinCEN. Only a small fraction of those SARs were evidence of actual money laundering, but the sheer volume of SARs demonstrates the current system's incentive for a financial institution to over-file SARs lest its prudential regulator conclude that it has too high of a SAR-triggering threshold in its internal AML policy.

The most recent update to AML rules went into effect on May 11, 2018. FinCEN's new Customer Due Diligence (CDD) rule requires a financial institution to identify and verify a company's "beneficial owner" when the company opens a new account and to monitor the account for changes in beneficial owner. A beneficial owner is a natural person that owns more than 25 percent of the company or that has "significant responsibility to control, manage, or direct a legal entity customer." [2] The CDD rule is designed to combat the use of shell companies and corporate layering to conceal illicit transactions. While many law enforcement groups support the rule because of the transparency it yields, other constituencies, including small businesses and financial institutions, point to compliance difficulties and high associated costs. These costs, on top of already very costly in-house AML compliance teams, have caused some financial institutions to consider "de-risking"—terminating *all* customer relationships in geographies or industries that may have a higher incidence of illicit finance regardless of whether a particular customer is a good actor—and thus cutting off mainstream banking services (and, with them, law

enforcement's ability to "follow the money") for developing countries, underserved communities, and legitimate international transactions.

Legislative Proposals to Modernize the BSA and Beneficial Ownership Rules

Members of the House and Senate have filed several bills to update the BSA/AML framework and address the use of anonymous shell companies in illicit finance. Rep. Stevan Pearce (R-N.M.) has introduced the Counter Terrorism and Illicit Finance Act (H.R. 6068, 115th Cong.), which would: (i) update the dollar amount filing thresholds for CTRs and SARs; (ii) require a formal interagency review of the BSA to generate proposals that ensure that information financial institutions provide is of a "high degree of usefulness" to law enforcement; (iii) permit financial institutions to share SARs with foreign branches and affiliates; (iv) create a no-action letter process at FinCEN; and (v) encourage the use of technological innovations in AML reporting. An earlier "discussion draft" version of the same bill contained a provision that would have required a company to file beneficial ownership information with FinCEN at the time it was incorporated in a state—a proposal very similar to the Corporate Transparency Act of 2017, introduced in the House (H.R. 3089, 115th Cong.) by Rep. Carolyn Maloney (D-N.Y.) and in the Senate (S. 1717, 115th Cong.) by Sen. Ron Wyden (D-Ore.). Other beneficial ownership proposals include, but are not limited to, Sen. Whitehouse's TITLE Act (S. 1454, 115th Cong.), which would require a corporation to disclose its beneficial owners to a state government at the time of incorporation, and Rep. Stephen Lynch's more targeted effort to prevent the use of large-dollar cash purchases of airplanes to launder money (H.R. 3544, 115th Cong.).

The House Financial Services Committee has held several hearings on BSA modernization and was scheduled to consider the Counter Terrorism and Illicit Finance Act on June 14, 2018, but consideration was postponed over concern for lack of support from committee members and law enforcement because the proposed legislation did not update beneficial ownership rules. The Senate Banking Committee, too, has held a few hearings on the subject of illicit finance and how to update BSA/AML rules, at which the topic of beneficial ownership has been thoroughly discussed. While the beneficial ownership issue appears to be a holdup at the moment, members of both parties agree on the need to update our BSA/AML framework. If members of Congress, law enforcement, financial institutions, and the business community can reach a compromise on beneficial ownership, legislation could move very quickly through both chambers and potentially become law, even as the legislative calendar becomes more challenging as midterm elections approach.

For more information about how to engage with Congress or the executive branch on BSA/AML modernization, including on the CDD rule, please contact Travis Norton at **tnorton@bhfs.com**.

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