Investigations, Compliance and Defense

Congress Passes Anti-Money Laundering Legislation Banning Anonymous Shell Companies

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Last week, a law designed to thwart the use of US shell companies by drug traffickers, terrorists, foreign adversaries, and others seeking to shield the provenance of their funds cleared Congress with bipartisan support. The Senate joined the House in overriding President Donald Trump's veto of the National Defense Authorization Act for Fiscal Year 2021 (NDAA), which includes a variety of reforms to anti-money laundering (AML) laws.

The key reform requires certain companies to disclose their ultimate owners to the Treasury Department's Financial Crimes Enforcement Network (FinCEN), making it harder for certain criminals to manipulate shell companies to launder money or evade taxes.[1] Although the law has various loopholes, it enhances the government's ability to detect and deter the use of shell companies to commit crime.

The specific requirements break down generally as follows:

- **Which Companies Must Report.** The ban on anonymous shell companies applies to organizations incorporated in the United States or foreign organizations that register to do business in the United States. Such "reporting companies" are broadly defined to include any "corporation, limited liability company, or other similar entity" that is "(i) created by the filing of a document with a US state or Indian Tribe or (ii) formed under the law of a foreign company and registered to do business in the United States." But importantly, as discussed further below, the definition of "reporting companies" excludes over 20 categories of regulated, publicly traded, non-profit, and government entities.

- **What Information Must Be Reported.** A reporting company must disclose to FinCEN the name, date of birth, address, and unique identifying numbers (e.g., a driver's license or passport number) of "beneficial owners" of the entity, which includes any person who (1) exercises "substantial control" over the entity or (2) owns or controls an equity stake of at least 25%. Notably, the law does not define the phrase "substantial control," leaving ample room for interpretation presumably until further guidance is issued by FinCEN.

- **Timing of Reporting.** Newly formed companies must report the requisite information at the time of formation, while reporting companies that already existed before the law's adoption must disclose the required information within two years. Reporting companies that subsequently experience a change in beneficial ownership must provide FinCEN with updated information within a year.

- **Access to Disclosures.** The bill authorizes FinCEN to share the information it receives with a federal agency "engaged in national security, intelligence, or law enforcement activity," and with state, local, and tribal law enforcement agencies where a court "authorize[s] the law enforcement agency to seek the information in a criminal or civil investigation." The act also allows FinCEN to share beneficial ownership information with financial institutions for customer due diligence purposes—with the reporting company's consent.

The disclosure requirement carries significant limitations and exceptions. First, the public does not have access to the beneficial ownership information collected by FinCEN. Second, there are over 20 classes of entities that are excluded from the disclosure requirement, including publicly traded companies and any entity that (1) has more than 20 full-time employees, (2) reports more than $5 million in annual revenue to the Internal Revenue Service, and (3) has an operating presence at a physical office within the United States. The law also authorizes the Secretary of the Treasury, in consultation with other federal agencies, to carve out additional exclusions to the term "reporting company." Third, because the disclosure requirements only apply to entities incorporated in the United States or registered to do business in the United States, the beneficial ownership trail may not lead very far if a reporting company is beneficially owned by a non-reporting company.

The limited ban on anonymous shell companies has been in the works for over a decade, and its implications could be wide-reaching. Nearly two million corporations and limited liability companies are registered each year in the United States but few states require companies to disclose their true owners.

Even with its limitations, the enactment of the legislation is a step toward tightening the defenses of the US financial system against illicit global actors. It should give regulators more effective and efficient tools to help protect the integrity of the American financial system by apprehending criminals and identifying and countering illicit financial activity. The government has noted that anonymous companies cause widespread harm, including by allowing corrupt foreign leaders, drug cartels, and human traffickers to launder illicit proceeds through US financial institutions.[2]

The legislation also brings the United States closer to the European Union (Fourth Anti-Money Laundering Directive) and UK (People with Significant Control Register)[3] by requiring entities to disclose financial information, and will thereby deter criminals from attempting to use US financial institutions to conceal the source and nature of illicit funds. In this way, the legislation could improve the overall reputation of the American financial system, and increase international confidence in the US economy.

The legislation may also save financial and other institutions' resources by aiding in their collection of accurate data about their clients. US banks, for instance, will be able to access beneficial owner information in the national registry, although banks will need to obtain consent from the pertinent current or potential customer. This should make compliance with due diligence requirements more efficient and accurate. By relying on the registry of information submitted by customers and potential customers, and compiled by the government, banks will be able to find covered beneficial ownership information with a few clicks and follow up with the current or potential customer if necessary.

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[1] S. 4049, 116th Cong. (2020); H.R. 6395, 116th Cong. § 6403 (2020), available here. Other AML-related laws in the NDAA expand the ability of financial institutions to share SARs with foreign affiliates, H.R. 6395, 116th Cong. § 6212 (2020); increase penalties for Bank Secrecy Act (BSA) and AML violations, *id*. § 6312; and create a private right of action for whistleblowers who are retaliated against for disclosing BSA violations, *id.* § 6314.

[2] Through this legislation requiring the unmasking of the persons who ultimately own or control a legal entity, Congress seeks to mitigate various harms, including: (1) Reducing havens for tax evasion. Bad actors often use shell companies as a means to evade paying taxes on legitimate earnings. (2) Thwarting the use of anonymous companies to purchase real estate to avoid fund transfer limits out of their home nations, evade taxes, or undermine economic sanctions. This conduct may in turn artificially inflate real estate prices and fuel the loss of affordable housing,

[3] The EU registry is accessible by law (EU 2015/849) to "any person or organization that can demonstrate a legitimate interest"; the UK register is publicly accessible. Similar to the AML laws in the

NDAA, the UK law broadly defines a beneficial owner as including an individual who holds more than 25% of shares/voting rights in a company, or a person "with significant control." Part 21A to the Companies Act 2006 as inserted by Sch. 3 of the Small Business, Enterprise, and Employment Act 2015; *see also* People with Significant Control Regulations SI 216/339, SI 2009/1804, & SI 2016/375. However, the UK law broadly defines a person with "significant control" as including anyone who has the right to appoint or remove majority of a board of directors. The EU law defines beneficial owners even more broadly, as including in the case of trusts, foundations, or entities similar to trust, the settlor, trustee, protector, beneficiaries, or class of persons in whose main interest the legal arrangement or entity is set up or operates, and any other natural person exercising more than 25% or "ultimate control" over the trust by means of direct/indirect ownership or other means.

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