AML Law

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Impact Assessment

- KYC and CDD requirements are significantly simplified and law-enforcement data improved by new beneficial-ownership disclosure requirements.
- FBOs now face increased risk for parent-bank activities outside the U.S., creating legal and reputational risk concerns for FBOs but new obstacles for dollar-denominated criminal ventures.
- Digital currency and firms handling it now come even more clearly under U.S. AML/CFT law.
- Cautious steps to greater regtech and suptech are authorized.

Overview

In a cliff-hanger before the end of the 116th Congress, the National Defense Authorization Act was enacted into law with an array of provisions significantly revising U.S. anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements. The most consequential of these is long-sought standards requiring beneficial-ownership reporting that enhance the accuracy of bank know-your-customer (KYC) investigations and reduce associated compliance burden as well as risk. However, the new law also extends the reach of U.S. law enforcement to any foreign bank doing correspondent business with a U.S. bank, raising legal and reputational risk despite questions about such a sweeping exterritorial application of one nation's standards. Digital currencies and exchanges or transmitters of them now also expressly come under codified AML/CFT requirements that increase compliance burden and risk but enhance law enforcement's reach into an area of growing concern.

Impact

Knowing the beneficial owners of shell companies has become an international AML priority to address tax evasion, criminal activity, and terrorist financing. As a result, the global AML governing body, the Financial Action Task Force (FATF), has issued standards designed to ensure effective disclosures. Until passage of the NDAA, the U.S. was a laggard with regard to these requirements, with efforts to comply at the federal level often stymied by state restrictions blocking access to beneficial-ownership information. This encourages companies to charter in protective states, but at considerable AML risk according to global authorities and Treasury's Financial Crimes Enforcement Network (FinCEN). States willing to improve data capture and transparency have also expressed reluctance to do so in the absence of a federal requirement due to fears of losing corporate charters and resulting revenue to less onerous states.

The new beneficial-ownership provisions thus provide greater legal certainty, increase U.S. adherence to global standards, and afford significant compliance-, legal-, and reputational-risk protection for banks and all other entities subject to U.S. AML law.

Although banks were strong advocates of the new law, law enforcement and the Treasury Department also pressed hard for it not just due to implications for compliance across the traditional financial industry, but also because of the growing importance of opaque digital currencies and non-traditional banks. The new law ends any doubt as to whether digital currencies and those handling transactions in them are exempt from AML and/or CFT requirements. FinCEN late last year issued an urgent change to reporting for certain digital-currency vehicles, sparking complaints that it lacked the authority to do so. The new law may well end any disputes in this area.

As noted, the new law extends the transnational reach of federal law enforcement to foreign banks that have correspondent-banking relationships with U.S. banks, making them subject to subpoena requests. The records that may be sought need not have anything to do only with AML investigations and thus could cover tax, sanctions-violations, bribery, and any other criminal or, in certain cases, civil matter. Notably, neither the FBO nor any of its parent or affiliate entities needs to have participated in any way in the alleged violations for its records to be subject to this new subpoena power. Although the law does not limit its scope only to FBOs with a U.S. presence, the challenges to extraterritorial application of U.S. law to foreign banks makes the impact of this provision most acute for FBOs in the U.S. Even a representative office or similarly-small entity could expose a foreign bank to risk because of the importance of dollar-clearing operations in the U.S., making it still more imperative not only that FBOs abide by U.S. law in the U.S., but also that home-country or related activities eschew customers whose activities raise suspicion.

Importantly, the new law authorizes U.S. authorities to subpoena FBO records even if the alleged violation does not pertain to a correspondent banking relationship. However, procedural requirements governing prosecutors seeking foreign records may provide some protections for FBOs, with the reach of the new law likely also subject to court challenge on grounds of undue extraterritoriality. But, even if subpoenas are successfully resisted, FBOs will surely incur significant reputational damage as well as legal cost – the law also gives U.S. authorities authority to petition

the court for sanctions applicable to cases of contempt that could well lead to charter revocation.

Many industry advocates had hoped that this law would also make it easier to use artificial intelligence and other techniques to enhance regulatory reporting (so-called regtech) and some agencies are also interested in enhancing supervisory technology (suptech). However, the new law only establishes several new efforts to consider these innovations, making it clear that regtech or suptech programs must not only be more efficient, but also more effective prior to adoption.

What's Next

Congress enacted this law on January 1 after overriding President Trump's veto. Effective dates for specific provisions are discussed below.

Analysis

A. Beneficial Ownership

1. Filing Requirements

The bulk of these requirements falls on the filings that many smaller corporations and similar entities will need to make no later than two years following Treasury rules mandated no later than January 1, 2022. Newly-formed entities or those with changes of ownership under the new standards would thereafter also need to file reports, but the overall timeframe could accelerate if Treasury and other federal agencies think necessary. Information filed on these reports is to be held in the strictest confidence, with information transmission governed by new Treasury rules and limited to conveyance by FinCEN to financial institutions; federal functional regulators; federal national-security, law-enforcement, or intelligence agencies; state, local, or tribal law-enforcement agencies, under limited circumstances; and certain international entities, with limitations also applicable here.

Reflecting deep privacy and burden concerns not fully redressed with an array of restrictions, the new law requires not only a series of Treasury reports and testimony to Congress, but also a Department of Justice audit of how Treasury implements beneficial-ownership requirements.

2. Customer Due-Diligence (CDD) Standards

No later than one year after Treasury's filing rule becomes effective, Treasury is also to revise existing CDD regulation[1] to conform current rules to new requirements and to reflect the benefit of this new information to CDD and KYC requirements, reducing burden. Although the new rules may not in any way rescind CDD and KYC

[1] See **LAUNDER121**, *Financial Services Management*, May 31, 2016.

requirements, Treasury is told to consider the use of risk-based principles, how financial institutions use beneficial-ownership information, and ways to improve timeliness.

B. Information Sharing

A new pilot program allows financial institutions to share SAR information with foreign branches, subsidiaries, and affiliates other than those located in China, Russia, U.S.-sanctioned nations, or those Treasury thinks unfit as long as current confidentiality restrictions are maintained. The law also bars U.S. financial institutions from establishing offshore AML-compliance operations, a provision ensuring full U.S. accountability for AML actions in foreign branches, subsidiaries, and affiliates. Rules implementing this must be in place by January 1, 2022, with the law giving Treasury authority to approach this pilot carefully and in concert with an array of additional safeguards (e.g., additional data-security and privacy protections). Arrangements ensuring Treasury enforcement authority against foreign subsidiaries and affiliates are also mandated. The pilot is to end in three years but could be extended another two with notice to Congress. If Treasury thinks the pilot proves successful, it must go back to Congress with an extensive report to seek statutory authorization for ongoing information sharing.

In addition, the law creates a "FinCEN exchange." It is to initiate voluntary public-private information sharing to promote reporting innovation, prevent illicit finance, and enhance protections for national security.

C. Digital Currency

The definition of transactions subject to AML reporting is expanded to cover services provided with respect to money, securities, and other transactions already directly subject to the law and to things of value that substitute for money and other traditional financial assets. Businesses engaged in exchanging or acting as money transmitters not only for funds, but now also for things of value that substitute for currency, funds or other value are also clearly brought under AML law, with Treasury required to issue new rules in this arena without a deadline set for doing so.

D. Compliance Sharing

The law authorizes AML-compliance collaborations among financial institutions, codifying a 2018 inter-agency statement on such efforts and mandating outreach to expand their use.

E. Law-Enforcement Cooperation

A statutory safe harbor from AML risk is provided for financial institutions complying with "keep-open" orders from federal law enforcement and, in certain cases, other agencies which stipulate that accounts must be maintained no matter the likelihood of customer criminal or similar activity. However, this safe harbor applies only if the law-enforcement agency has notified FinCEN of its order or FinCEN has approved it. Further, the safe harbor only applies within the parameters of the keep-open request, meaning that the financial institution may be liable for any prior AML violations and the institution must continue to comply with all AML requirements in the course of any such order. Keep-

open letters must also have termination dates, after which the entity may also be AML liable.

Treasury and other agencies are to provide guidance on risks related to keep-open letters, although the law does not say when.

F. FBOs with Correspondent Accounts

As noted, the law expands DOJ and Treasury subpoena authority governing foreign-located bank records if a foreign bank maintains a correspondent account with a U.S. bank regardless of whether the correspondent account was used in the course of investigations related to federal criminal law, civil asset-forfeiture proceedings, or BSA/AML law or rule violations. FBOs may petition for relief from any such subpoena under a process detailed in the law, but a defense against compliance with the subpoena that doing so violates applicable non-U.S. law may be discarded by U.S. authorities. Significant penalties apply if the foreign bank discloses such a subpoena to anyone involved, with overall penalties for FBOs significantly increased for repeat violators and for any U.S. institution that fails to terminate a correspondent relationship with a non-compliant FBO. Penalties may be recouped from correspondent accounts if the FBO fails to honor an enforcement order. New data-maintenance requirements are also created.

G. Enforcement

Key provisions in this arena:

- create new incentives for whistleblowers to voluntarily report original information leading to significant and successful AML enforcement actions. Whistleblower protections are also improved, with these provisions subject to new Treasury regulation;
- increase penalties, especially for repeat violators, including recapture of all profits associated with an AML violation;
- prohibit serving on U.S. financial institution boards by certain AML or CFT violators; and
- bar concealment of asset sources in monetary transactions with aggregate value greater than $1 million, with this term defined in ways that may not reach to digital-currency transactions by senior foreign political officials or their close associates or family members. Significant criminal penalties and/or funds forfeiture apply to persons or conspiracies that violate this requirement.

H. Innovation Officers

FinCEN and federal financial regulators are now ordered to appoint innovation officers to promote AML implementation and enforcement innovation, provide technical advice, and, if desired, create partnerships and performance metrics.