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Client & Friends Alert[1]

Corporate Transparency Act (CTA):

Financial Implications Part 2: Banking Transactions

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I. CTA Highlights for Banking Transactions

This is the second of a two-part alert about the Corporate Transparency Act (CTA)'s financial implications: this one about banking transactions.[2]

To recap, effective January 1, 2024,[3] the CTA requires an estimated 33 million small businesses[4] ("reporting companies") to report information to the U.S. government about their beneficial owners by January 2, 2025.

The CTA's reporting requirements are intertwined with related regulations under the Bank Secrecy Act ("BSA"). These impose due diligence, so-called "know your customer" or "KYC" obligations on financial institutions, which in turn carries implications for loan

[1] While accurate to the best of our knowledge, the discussion herein is for tutorial purposes only. It is not to be deemed a legal opinion or legal advice. Should you wish to discuss this disclaimer (or require legal assistance), please contact us at wsapronov@wstelecomlaw.com

[2] The first part of this alert described CTA implications for Investment Transactions. See https://www.linkedin.com/posts/walt-sapronov-4909021_corporate-transparency-act-financing-transactions-activity-7239385784326270978-8BVi?utm_source=share&utm_medium=member_desktop

[3] 31 U.S.C. Section 5336. The CTA is a part of the Anti-Money Laundering Act of 2020, which is included in the National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, §§ 6001-6511, 134 Stat. 3388 (2021) ("NDAA") .

[44] https://www.fincen.gov/what-money-laundering#:~:text=Money%20laundering%20involves%20disguising%20financial,with%20an%20apparently%20legal%20source

agreements and other banking transactions involving affected businesses. Understanding and dealing with these implications when negotiating loan agreements and other banking transactions is the subject of this alert.

II. **The Intertwined Purposes of the CTA and the BSA**.

Briefly, the CTA's legislative purpose[5] is to enhance national security by combatting money laundering and other financial crimes conducted through use of shell companies and other anonymous corporate structures. The CTA does this by requiring disclosure of their beneficial owners.

The Anti-Money Laundering Act of 2020 (which includes the CTA) also amended the Bank Secrecy Act (BSA),[6] to aid in the prevention of money laundering, terrorism, and other illicit activities. The CTA's legislative purpose thus overlaps with that of the BSA.[7]

III. **CTA & BSA Compliance**.

Under both under the CTA and the BSA, money laundering enforcement is conducted by the Financial Crimes Enforcement Network (FinCEN) (https://www.fincen.gov/).

FinCEN's published CTA Rules (https://www.fincen.gov/boi) require all small business entities (so-called "reporting companies") to disclose their "beneficial owners".[8] A company "applicant", an individual or entity who makes the filing on behalf of the Reporting Company (*e.g.*, one of its officers or attorneys) is also required to disclose its beneficial ownership. The reported information is stored in a beneficial owner information ("BOI") database.

In parallel with the CTA, the BSA requires banks and other financial institutions, among other things, to make report suspicious activities.[9] Relatedly, in May 2016, FinCEN first issued its Customer Due Diligence (CDD) requirements.[10] The existing CDD Rule became effective May 11, 2018, requiring banks and other "covered financial institutions" to identify and verify the identity and beneficial owners of "legal entity companies" – a designation roughly comparable to "reporting companies" under the CTA.

1. The CDD Rule.

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[5] National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6402, 134 Stat. 3388 (2021).
[6] The Bank Secrecy Act, primarily codified at 2 U.S.C. §§ 1829b, 1951-1959, and 31 U.S.C. §§ 5311-5332. The BSA was originally enacted as the Currency and Foreign Transactions Reporting Act of 1970.
[7] 31 CFR 1010, 86 FR 17447, FinCEN Proposed Rule, https://www.federalregister.gov/documents/2021/04/05/2021-06922/beneficial-ownership-information-reporting-requirements (citations omitted)
[8] For a brief synopsis of CTA reporting requirements, please see https://wstelecomlaw.com/2024/01/corporate-transparency-act-cta-a-synopsis/
[9] 31 CFR 1010, 86 FR 17447, FinCEN Proposed Rule, https://www.federalregister.gov/documents/2021/04/05/2021-06922/beneficial-ownership-information-reporting-requirements (citations omitted)
[10] See generally https://www.americanbar.org/groups/business_law/resources/business-law-today/2021-may/the-corporate-transparency-act/

This CDD Rule – also known as the "fifth AML (Anti-Money Laundering) pillar" of the BSA - requires covered financial institutions to establish a risk-based program for conducting ongoing customer due diligence or "CDD". Essentially, the CDD Rule obligates financial institutions to maintain ongoing customer identification and verification (so-called "know your customer (KYC)" programs, to monitor suspicious activity, and to report suspicious transactions.

Upon detection of suspicious activity that could involve money laundering, fraud or other financial crimes, Banks and other financial institutions must report such suspicious transactions through issuance of a suspicious activity report (SAR).[11]

The process begins when the bank identifies and flags an unusual activity (*e.g.*, unusual transaction patterns) involving a customer. The bank then investigates and, upon meeting certain threshold conditions, files a confidential SAR to FinCEN (without disclosure to the customer). Threshold criteria include detecting transactions of $5,000 or more or other suspicious activity that a bank reasonably suspects are derived from illicit activities, are intended to disguise such activities or are used to evade regulations (*e.g.*, sanctions). Examples include breaking down large amounts into multiple small deposits - for example, in amounts just under $10,000 to avoid IRS reporting requirements,[12] transfers from high-risk geographic locations, rapid movement of funds, and other suspicious patterns.

2. <u>BOI Disclosure to Financial Institutions</u>

In December 2023, FinCEN published a rule effective February 20,2024 ("Access Rule") [13] protecting its collected BOI information from disclosure except under limited circumstances for reasons such as national security, intelligence, and law enforcement. [14] Among the exceptions, however, is provision of BOI to financial institutions to facilitate CDD rule compliance – but only with the consent of the reporting company (*e.g.*, the bank customer). The Reporting Company (customer's) consent must be documented – but not necessarily given in writing.[15]

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[11] 31 U.S.C. Section 5318(g); 31 C.F.R. Section 1020.320

[12] 26 U.S.C. Section 6501 (requiring any person or business receiving cash payments of more than $10,000 to report it to the IRS using Form 8300).

[13] FinCEN Interagency Statement for Banks on the Issuance of the Beneficial Ownership Information Access Rule, Dec.21, 2023); https://www.fincen.gov/sites/default/files/shared/Interagency_Statement_for_Banks_On_the_Issuance_of_the_Access_Rule_12.15.2023.v2.pdf

[14] FinCEN, Beneficial Ownership Information access and Safeguards, Final Rule, Federal Register, Vol. 88, No. 245, 88732 (December 22, 2023)

[15] See generally, "Corporate Transparency Act's Impact on Banking", Strafford Seminars Presentation April 9, 2024 (available at https://www.straffordpub.com/products/corporate-transparency-acts-impact-on-banking-ensuring-compliance-interplay-with-know-your-client-due-diligence-rules-2024-04-09

FinCEN expects to revise its current CDD rule to reconcile it with expanded access by banks and other covered financial institutions to BOI reported to FinCEN. This will expand the institutions' permissible use of BOI comply with broader anti-money laundering and counter-terrorism financing obligations. No date has been given for this expected revision.

IV. Implications for Loan Agreements and Other Banking Transactions.

The related CTA and BSA requirements for banks and other covered financial institutions will affect loan agreements and other financing transactions with their reporting company customers.

For instance, in the case of loan agreement, one way a "covered" financial lender might secure documented consent to access a borrower's BOI (as required by the CDD rule) would be to include it as a condition to draw down in a credit agreement or other loan document.[16] Similarly, banks may include CTA compliance, including reporting and updating information, in the borrower's representations, warranties and covenants– thus perhaps shifting the bank's CDD compliance obligations on to the borrower.

Careful attention to CTA and CDD requirements could thus become a staple of credit agreements, security agreements, inter-creditor/subordination agreements and other loan documents.

There is more. Assuming that for whatever reason, a banking customer refuses to give consent for the bank's access to its BOI. In certain circumstances – for example, the borrower a foreign reporting company from a high-risk foreign location - that refusal could conceivably trigger a SAR. So perhaps could cross border money transfers viewed as "suspicious" by the bank.[17] Customers (especially foreign ones) should thus be prepared to i) strictly comply with CTA reporting requirements, ii) disclose that information to its Bank, and iii) consider the implications of a possible SAR should any of the foregoing be considered suspicious in the eye of the beholding bank.

For assistance with CTA compliance, please contact us at wsapronov@wstelecomlaw.com or by text or phone at (770) 309-0462.

[16] See G.H. Singer, "Corporate Transparency Act – Takeaways for the Banking Industry". https://www.hollandhart.com/corporate-transparency-act-takeaways-for-banking-industry.

[17] For a discussion of these implications presented by the author at a Center for International Legal Studies (CILS) conference in Bad Gastein, Austria, see https://wstelecomlaw.com/2024/02/cils-conference