

Anti-Corruption Hot Topic: Corporate Transparency Emerges as Cornerstone of Financial Integrity Regulatory Reforms

By Elizabeth G. Silver and Catherine A. Johnson

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The Against the backdrop of the Pandora Papers, increasing corporate transparency has become a cornerstone for improving financial integrity by pulling back the veil on illicit money flows that facilitate bribery, money laundering, tax evasion, terrorism financing, human trafficking, and other human rights abuses.ⁱ In October 2021, the Pandora Papers dropped like a bombshell, revealing previously confidential financial information regarding more than 29,000 beneficial owners of offshore assets worth billions of dollars.ⁱⁱ The data, released by a group of investigative journalists, reveals information regarding the corporate vehicles used by heads of state, politicians, ambassadors, generals, and more than 130 billionaires from forty-five countries to hide such information.ⁱⁱⁱ Although shielding assets offshore does not necessarily constitute a crime or indicate that one has been committed, global enforcement authorities point to opaque corporate structures as a significant obstacle to investigating and prosecuting crime.^{iv} While there remain a series of jurisdictions that are perceived to be tax havens, impending regulatory changes in the United States will chip away at the anonymity that enables illicit finances to flow untraceably.

Following decades of criticism from the global anti-money laundering community for not being tough enough on anonymous shell companies,^v and recognizing the patchwork of state and local requirements on corporate formation and reporting, the United States has taken a significant step toward reform. New regulations in the pipeline will introduce nationwide standards and increase transparency into the ownership of certain categories of corporations registered or operating in the United States. As acknowledged in the legislation, the new procedures have “the purpose of preventing money laundering, the financing of terrorism, proliferation financing, serious tax fraud, and other financial crime by requiring nonpublic registration of business entities formed or registered to do business in the United States.”^{vi} Importantly for entities that will need to begin disclosing ownership information, the beneficial ownership information generally will not be publicly available, which will help protect confidentiality for legitimate businesses and alleviate security concerns for individuals whose assets may be listed in the database. However, these regulations will have the effect of giving U.S. law enforcement access to the true owners behind entities formed or registered in the United States to suss out illicit activity.

In this article, we provide an overview of the key provisions of the Corporate Transparency Act (“CTA”), which, through the Anti-Money Laundering Act of 2020, became law on January 1, 2021, as part of the National Defense Authorization Act for Fiscal Year 2021. We also identify key implications for our clients and friends, and we provide some insights regarding conducting due diligence surrounding the Pandora Papers.

Regulatory Backdrop

Anti-money laundering regulation and enforcement is carried out by a complex web of domestic and international players. In practice, a significant component of anti-money laundering and anti-terrorist financing work is carried out by the private sector, and particularly financial institutions, which are under rigorous requirements to conduct due diligence on their customers and report certain categories of suspicious transactions to the government.^{vii} The CTA will require that certain categories of businesses file reports with the U.S. government regarding their beneficial owners. This information will be available not only to financial institutions subject to customer due diligence requirements, but also to U.S. and, under certain circumstances, foreign law enforcement.^{viii} The new reporting carried out under the CTA will be overseen by the Financial Crimes Enforcement Network (“FinCEN”), which is part of the U.S. Treasury Department.^{ix}

The CTA will not impact all businesses equally. Following an overview of the key provisions of the new regime, we address the impacts on three categories of our readers: (1) companies that will be considered “reporting companies” and required to file;

(2) financial institutions that will access the registry; and (3) other businesses, which will not have direct reporting obligations or access to the ownership information collected under the CTA.

Key Provisions

The CTA will create a new category of regulated entities called reporting companies.^x A reporting company is defined as a corporation, LLC, or other similar entity that is (i) created by the filing of a document with a secretary of state or a similar office under the law of a state or Indian tribe, or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a state or Indian tribe.^{xi} Certain categories of entities are exempt from the reporting requirement: certain types of issuers; certain registered entities; banks; credit unions; public utility companies; certain tax exempt entities; entities with more than twenty full-time employees, revenue greater than \$5 million, and a physical operating presence in the United States; entities owned or controlled by other entities that qualify for one of several other specified exemptions; and certain dormant entities, among others.^{xii} Implementing regulations are due out in late 2021 to provide additional details regarding which entities will qualify for exemptions from the reporting requirements.

Under the CTA, reporting companies will be required to submit to FinCEN certain information regarding (1) their beneficial owners and (2) the person who registered or filed an application to register the reporting company in the United States.^{xiii} The CTA defines a beneficial owner of an entity as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise (i) exercises substantial control over the entity, or (ii) owns or controls not less than twenty-five percent of the ownership interests of the entity.^{xiv} The information that will be required to be reported includes (i) full legal name, (ii) date of birth, (iii) current residential or business street address, and (iv) a unique identifying number from an acceptable identification document or the individual's FinCEN identifier.^{xv}

The new reporting requirements have not yet taken effect, and in fact may still be years away for some regulated entities. Implementing regulations for the new reporting system are due out no later than January 1, 2022.^{xvi} The date they will take effect, which will trigger when reporting obligations will begin, has not yet been set.^{xvii} However, the general timelines have been specified. Once the final regulations have been issued and take effect, newly formed entities will be required to file their reports upon formation.^{xviii} Existing entities will have a period of two years from the new effective date, which has not yet been determined, to submit their reports.^{xix} From then on, once reporting companies are registered with FinCEN, subsequent changes in beneficial ownership will have to be reported within one year.^{xx}

Recognizing legitimate concerns about divulging ownership information, the regulations include significant restrictions on how the information is to be stored and when it can be disclosed. FinCEN is required to maintain the information in a confidential, secure, and non-public database.^{xxi} FinCEN will be authorized to disclose the information to financial institutions to assist in meeting their customer due diligence ("CDD") obligations, and also to certain government agencies for certain purposes specified in the CTA.^{xxii} FinCEN will be permitted to disclose beneficial ownership information upon receipt of (i) a request from a federal agency engaged in national security, intelligence, or law enforcement activity, (ii) a request from a non-federal law enforcement agency with court authorization, (iii) a request from a federal agency on behalf of certain foreign requestors under specified conditions, (iv) a request by a financial institution subject to CDD requirements with the consent of the reporting company, and (v) a request by a Federal functional regulator or regulatory agency under certain circumstances.^{xxiii} Of note, the authorized law enforcement activities are not limited to those carried out by U.S. authorities. Information in the registry may, under certain circumstances, be obtained by law enforcement authorities outside the United States for use in criminal and civil proceedings.

Impact on Our Clients

For our clients that will face filing requirements as reporting companies, many of the details regarding the procedural aspects of the filings will be forthcoming with FinCEN's implementing regulations. In the meantime, assigning responsibility for FinCEN regulatory compliance and ensuring adequate resources will be available to satisfy the obligations is advisable, as non-compliance accrues daily penalties and potential civil and criminal exposure.^{xxiv}

Financial institutions that are subject to customer due diligence requirements will be able to request beneficial ownership information from the FinCEN registry as part of the CDD process with the consent of the reporting company.^{xxv} One challenge for financial institutions will be developing appropriate guidelines for CDD on established clients that become reporting companies under the CTA, but that are not required to file their information for up to two years. The period while the CTA is affecting certain swaths of customers will present unique challenges for administering and complying with CDD requirements.

For the rest of our clients, on its face, the CTA will have little impact on your due diligence programs. However, it bears mention that financial institutions will gain a significant information advantage on reporting companies that have a potential nexus to corruption, money laundering, proliferation, terrorist financing, and other financial crimes. Therefore, your diligence process should be mindful of red flags indicating that a potential counterparty is having trouble gaining access to the U.S. financial system

or may be the subject of law enforcement inquiries. Any such red flags should be fully resolved before proceeding with the counterparty.

Due Diligence Regarding the Pandora Papers

The International Consortium of Investigative Journalists (“ICIJ”) reports that 30,000 companies are implicated in the Pandora Papers records,^{xxvi} suggesting there is a significant likelihood our clients may encounter implicated parties through their due diligence processes. At this time, it is not possible to fully conduct due diligence for potential links to the Pandora Papers because the complete data from the Pandora Papers has not yet been published. Rather, reports of investigation results are being periodically released by the ICIJ and more than 150 media partners.^{xxvii} For the time being, open source research, including in local languages, should be performed for publicly available information regarding links to the Pandora Papers. Eventually, it will be possible to search the underlying data. The ICIJ reportedly^{xxviii} will be incorporating the data into its Offshore Leaks Database, and will likely publish Excel files detailing the names of entities, subsidiaries, officers, and addresses included in the data, as it has with prior investigations.^{xxix} The Database currently contains the data associated with prior investigations, which can be searched by the public.

Once populated, the Database can be searched, and will further serve as a useful tool for clients to perform due diligence on third parties with which they do business. The Database allows searches for entity names, officer names, intermediaries, and even addresses. However, ICIJ does not publicly release the underlying records it obtained. In this way, the Database is only a first step to determine whether additional diligence may be required to investigate why the party was named.

If you have any questions about the article please contact **Elizabeth G. Silver** at +1 (202) 312 3012, **Catherine A. Johnson** at +1 (202) 312 3367 or any other Vedder Price attorney with whom you have worked.

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ⁱ International Consortium of Investigative Journalists, “About the Pandora Papers,” available at: <https://www.icij.org/investigations/pandora-papers/about-pandora-papers-investigation/> (last visited Oct. 21, 2021).

ⁱⁱ *Id.*

ⁱⁱⁱ *Id.*

^{iv} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6402 (2020).

^v Financial Action Task Force, Executive Summary, Mutual Evaluation Report, “United States’ Progress in Strengthening Measures to Tackle Money Laundering and Terrorist Financing,” at 2 (Dec. 2016) (last visited Oct. 21, 2021).

^{vi} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(e)(2)(B) (2020).

^{vii} U.S. Bank Secrecy Act, 31 U.S.C. §§ 5311-5332.

^{viii} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(c)(2)(B) (2020).

^{ix} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(b)(1) (2020).

^x Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(a)(11)(A) (2020).

^{xi} *Id.*

^{xii} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(a)(11)(B) (2020).

^{xiii} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(b)(2) (2020).

^{xiv} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(a)(3) (2020).

^{xv} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(b)(2) (2020).

^{xvi} Beneficial Ownership Information Reporting Requirements, 86 Fed. Reg. 17557, at 17558 (proposed Apr. 5, 2021) to be codified at 31 C.F.R. 1010.

^{xvii} *Id.*

^{xviii} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(b)(1)(C) (2020).

^{xix} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(b)(1)(B) (2020).

^{xx} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(b)(1)(D) (2020).

^{xxi} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(c)(8) (2020).

^{xxii} Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(c)(2)(B) (2020).

xxiii *Id.*

xxiv Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(h)(A) (2020).

xxv Corporate Transparency Act, H.R. 6395, 116th Cong. §§ 6402-6404, at § 6403(a)(c)(2)(B)(iii) (2020).

xxvi International Consortium of Investigative Journalists, “About the Pandora Papers,” available at: <https://www.icij.org/investigations/pandora-papers/about-pandora-papers-investigation/> (last visited Oct. 21, 2021).

xxvii See *Pandora Papers: An offshore data tsunami*, Int’l Consortium of Investigative Journalists (Oct. 3, 2021), <https://www.icij.org/investigations/pandora-papers/about-pandora-papers-leak-dataset/>.

xxviii See *Pandora Papers: An offshore data tsunami*, Int’l Consortium of Investigative Journalists (Oct. 3, 2021), <https://www.icij.org/investigations/pandora-papers/about-pandora-papers-leak-dataset/> (“ICIJ is planning to incorporate data from the Pandora Papers into the Offshore Leaks database.”)

xxix International Consortium of Investigative Journalists, Offshore Leaks Database, <https://offshoreleaks.icij.org/> (last visited Oct. 21, 2021).