CLIENT ALERT

National Defense Authorization Act for Fiscal Year 2021 Has Instituted Sweeping Changes To Reporting Requirements for CLG Clients

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/ 800 MAINE AVENUE SW / SUITE 200
WASHINGTON, DC 20024 / 202.000.0000 / info@capitol.law

Client Alert –National Defense Authorization Act for Fiscal Year 2021 Has Instituted Sweeping Changes to Reporting Requirements for CLG Clients

In the waning hours of the Trump Administration, Congress quietly snuck through major changes in the anti-money laundering (AML) obligations of nearly every type of company doing business in the United States as a part of the National Defense Authorization Act for FY 2021. The new law, which includes provisions that have long been on the wish list for the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN), will usher in major changes to the reporting obligations of many of Capitol Law Group's clients. Moreover, the new law creates new enforcement mechanisms, new civil and criminal enforcement provisions, and issues clear directives to U.S. regulators to aggressively enforce the new law and issue new regulations implementing the changes. In short, our clients must aggressively revise their compliance protocols and ensure timely updates to their regulatory filings, or else they could face significant regulatory scrutiny.

The National Defense Authorization Act (NDAA) is a yearly law meant to allocate funding to U.S. defense agencies. However, in recent years it has been a notorious vehicle for enacting significant changes in a wide variety of American law. Because the bills must pass to ensure funding for the military, they typically contain controversial or otherwise significant changes in the law with little to no meaningful consideration by Congress.

The 2021 Act is no different. Buried within its thousands of pages of text are a number of significant changes for CLG's clients. We summarize some of the most significant below.[1]

Expansion of the Bank Secrecy Act

The Bank Secrecy Act (BSA) is one of the most important sources of legal oversight for our clients involved in financial services. While traditional banks are obviously regulated by the BSA, the Act and its corresponding regulations apply to large swathes of the U.S. economy, such as broker-dealers, insurance companies, money transmitters, and even businesses like pawnbrokers, travel agents and dealers in precious metals.

In recent years business dealing in virtual currencies (e.g. Bitcoin), have faced uncertainty over whether they fall under the BSA. The 2021 NDAA resolves that question in Section 6102(c), expanding the existing definition of regulated entities to include businesses that deal in "currency, funds, or value that substitutes for currency." Similarly, Section 6110 expands the BSA to dealers in antiquities and arts, including those who merely advise such dealers. Those entities now falling under the BSA's reach must significantly re-examine their operations and implement robust AML compliance.

Beneficial Ownership Reporting

[1] This is not a comprehensive list of all changes in the Act, nor is it legal advice concerning the changes. You must seek individual advice from CLG's attorneys to ensure your compliance with these new provisions as well as existing laws and regulations.

Perhaps most significantly for CLG's client base, the NDAA imposes a new reporting requirement for almost *any* entity doing business within the U.S. concerning the entity's beneficial ownership information. Section 6403 requires any "corporation, limited liability company, or other *similar entity*" organized in any U.S. jurisdiction, as well as any foreign entity that registers to do business in the U.S. to identify every "beneficial owner" in filings with FinCEN. A beneficial owner is a natural person that is either a 25% or greater owner in the entity, *or* has "substantial control" over the entity, even if not formally recognized. Because the entity must identify a natural person, it is not sufficient to disclose ownership by another company. Instead, the entity must identify by name and date of birth the beneficial owners and provide an unexpired passport to FinCEN to confirm the identity of the beneficial owners.[2]

New entities will have to provide beneficial ownership information to FinCEN at the time of organization. Existing entities will have an initial two-year period to provide this information, but then must file yearly reports with FinCEN as well as supplemental reports if beneficial ownership information changes.

Fortunately, the beneficial ownership information will not be made public. However, FinCEN will share the information with law enforcement and regulators as well as financial institutions that are conducting due diligence concerning the entity. Therefore, our clients must anticipate that their beneficial ownership information will be widely available to U.S. parties.

Finally, there are robust civil and *criminal* enforcement provisions concerning the new obligations. If anyone willfully provides "false or fraudulent beneficial ownership information" or "willfully fails to report complete or updated beneficial ownership information" they are subject to civil penalties of at least $500 per day that the violation continued or up to two years in prison. This is a broad provision, and includes even intermediaries for the entity, such as agents who file the information with FinCEN. There are limited safe harbor provisions for those who attempt in good faith to comply with the requirements and promptly notify FinCEN of any errors.

The exact contours of these new requirements will arise from new rules issued by FinCEN—the Act directs the agency to issue implementing regulations within one year. But, to say the least, the Act will significantly alter U.S. practice for CLG's clients, particularly foreign entities doing business in the U.S. Our clients must ensure that they have plans in place to ensure compliance, discharge their affirmative obligations not to facilitate erroneous filings with FinCEN, and, if errors arise, work with CLG to promptly address potential liability.

Emphasis on Enforcement

In more general terms, the Act also contains a number of new provisions strongly suggesting an emphasis on civil and criminal enforcement of regulations concerning CLG's clients. The Act repeatedly emphasizes the "Sense of Congress" that current regulatory measures and enforcement have been inadequate to combat fraud and other misconduct. As a result, the Act contains increased penalties for certain BSA violations

[2] Some entities are exempt from this new requirement, but only those who already have robust reporting requirements under other laws. For example, broker-dealers and issuers of *registered* securities are exempt. Issuers of unregistered shares, however, will be required to comply with these provisions.

in Section 6309, new provisions ordering disgorgement of certain funds for BSA violations in Section 6312, and in Section 6501 expansion of the Securities and Exchange Commission's authority to impose sanctions against regulated entities.

Also noteworthy, in Section 6311, Congress has mandated that regulators and federal prosecutors provide a report on the use of deferred prosecution agreements and non-prosecution agreements. These agreements have been critical ways for entities to resolve investigations and alleged violations by U.S. authorities without admitting guilt or facing business-ending sanctions for technical violations of regulatory provisions. The demand for a report signals growing skepticism over the continued use of these agreements. Regulated entities should therefore expect an even more aggressive enforcement environment going forward.

Creation of New Rulemaking

Finally, the Act contains numerous directives for FinCEN and other federal agencies to issue rulemaking to implement the new laws. For example, in addition to being directed to implement the new beneficial ownership law, in Section 6216 FinCEN has been directed to engage in a comprehensive review of existing regulations and guidance concerning AML obligations. In Sections 6202, 6205, and 6305 FinCEN will also be required to start rulemaking concerning obligations to file currency transaction reports, suspicious activity reports, and the advisability of issuing no-action letters to regulated entities.

The final form that these rules will take will dramatically change the landscape and the obligations facing our clients. FinCEN and other regulators will have a tremendous amount of discretion in drafting the specific rules our clients will need to follow. But FinCEN has, in the past, shown its willingness to engage with stakeholders both before and during public comment periods concerning its rules. CLG's attorneys also have significant experience in engaging with regulators during the regulatory comment process. However, if stakeholders do not engage with regulators during this process, then other parties, such as law enforcement or competing industries with adverse interests, will influence the regulation in an unfavorable direction. Our clients must be willing to participate in this process to protect their bottom line.

Takeaways

The 2021 NDAA will issue sweeping changes that our clients must be prepared to address. Our clients must seek comprehensive advice on the impact of the new reporting requirements and expanded compliance obligations and ensure that they have adequate processes in place to avoid running afoul of their new legal responsibilities. Our clients must also be ready to participate in the development of new regulations to ensure that their interests are protected. Finally, our clients must be prepared for robust enforcement, and must take appropriate and early measures to de-escalate any investigations or regulatory inquiries.