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Treasury Proposes Regulations That Would Require Private Trust Companies to Establish or Enhance AML Programs and to Identify Beneficial Ownership of Legal Entities

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The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) published proposed regulations on August 25, 2016 that would require certain private trust companies utilized by high net worth individuals, as well as non-federally insured banks, to establish or improve anti-money laundering (AML) programs that include Customer Identification Programs (CIP) and that comply with Customer Due Diligence (CDD) requirements. Under the proposed regulations, a private trust company would have to identify the beneficial owner of any legal entity with an account, create and maintain adequate records, and, under rare circumstances, identify beneficial owners of legal entities to FinCEN.

Current Legal Environment

The Bank Secrecy Act authorizes FinCEN to issue regulations requiring financial institutions to develop and maintain AML programs, and to keep records and file reports that "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." Under the current rules, non-federally regulated banks are generally exempt from the requirement to establish an AML program, although they must comply with other Bank Secrecy Act requirements such as filing currency transaction reports or suspicious activity reports. Similarly, most financial institutions, including private trust companies, are required to establish and maintain CIPs as part of their AML program. In May 2016, FinCEN issued final regulations requiring certain financial institutions, including federally regulated banks, to comply with CDD rules, including identification of beneficial owners of legal entity customers, although the CDD rules apply only after May 11, 2018.

Overview of Proposed Regulations

The proposed regulations generally apply the CDD rules requiring customer and beneficial owner identification to non-federally regulated banks, such as private trust companies. The proposed regulations require all financial institutions to establish an AML program. In addition to establishing minimum standards for an AML program to comply with the Bank Secrecy Act, the proposed regulations require that the AML programs include CIPs and CDD procedures to identify and verify beneficial ownership of legal entity customers. The proposed regulation would use the definition of beneficial ownership from the final May 2016 CDD rules, which would include any individual who owns at least 25 percent of the equity interests in a legal entity customer, and a single individual with significant responsibility to control, manage or direct a legal entity customer.

Impact on High Net Worth Individuals

Many high net worth individuals and family offices have established private trust companies in states such as Nevada, Wyoming or South Dakota. The degree of regulation, taxation and asset protection offered under state law varies, but the structures typically enable wealthy individuals or families to exert greater control over investment decisions involving family investment assets or businesses held in trust, while continuing to offer liability protection for trust fiduciaries and avoiding SEC registration. If finalized in their proposed form, the regulations would require, for the first time, private trust companies and other non-federally regulated financial institutions to implement or improve AML and CIP programs.

The AML programs of private trust companies would have to include: (i) risk-based assessments of the customers to determine the company's risk profile; (ii) written policies, procedures, and internal controls to ensure a compliant program; (iii) independent testing to monitor and maintain program compliance; (iv) designation of a compliance officer; (v) ongoing employee training programs; (vi) procedures to verify the identity of individuals opening an account; (vii) procedures for ongoing CDD, including understanding the nature and purpose of customer relationships, ongoing monitoring to identify and report suspicious transactions, and maintaining and updating customer information such as the beneficial owners of legal entities; and (viii) due diligence programs for correspondent accounts for foreign financial institutions and private banking accounts. The proposed regulations would, therefore, increase the administrative costs of implementing a private trust company strategy and potentially eliminate the anonymity of using such a strategy. While the proposed regulations do not necessarily result in the disclosure of the identity of beneficial owners to the public or any government agencies, records of such identities will have to be created and maintained, and would be required to be disclosed if appropriately requested by FinCEN pursuant to an investigation or reasonable inter-agency or inter-governmental request.

Plan Ahead

There are many reasons for high net worth individuals and families to use a private trust company, but increased compliance costs and transparency must now be factors considered in entering into such arrangements. The identification of beneficial ownership of legal entities proposed in FinCEN's regulations for such private trust companies is consistent with the Treasury's treatment of beneficial ownership for purposes of other international tax reporting and disclosure regimes (e.g., ownership of foreign accounts under the Foreign Account Tax Compliance Act). The concept of beneficial ownership in the current FinCEN rules, however, continues to enable many individuals to avoid identification because banks are required only to identify an individual with significant responsibility to control or manage the legal entity, and individuals with at least a 25 percent ownership interest.

FinCEN has requested comments on the proposed regulations by October 24, 2016.

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