

## Expert Q&A on the Effect of the Corporate Transparency Act BOI Rule on Loan Transactions

by Daniel P. Stipano, Davis Polk & Wardwell LLP with Practical Law Finance

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An expert Q&A with Daniel P. Stipano, Davis Polk & Wardwell LLP, on the effect of the Beneficial Ownership Information Reporting Rule under the Corporate Transparency Act on loan transactions.

### What is the Beneficial Ownership Information Reporting Rule (BOI Rule) under the Corporate Transparency Act? What is the purpose of the BOI Rule and when is it expected to be effective?

The BOI Rule is the first of three rulemakings being conducted by the Financial Crimes Enforcement Network (FinCEN), a bureau within the US Department of the Treasury, to implement the Corporate Transparency Act (CTA) provisions of the Anti-Money Laundering Act of 2020 (31 U.S.C. 5336). The CTA is aimed at promoting financial transparency by establishing a national registry of beneficial owners of legal entities conducting business in the US, for the benefit of certain governmental agencies and entities, and, in some cases, financial institutions to facilitate their regulatory compliance obligations.

The BOI Rule will require certain legal entities to file reports providing information about the entity, its beneficial owners and, in some cases, its company applicants to FinCEN where it will be housed in the registry (31 C.F.R. 1010.380). The BOI Rule is scheduled to become effective on January 1, 2024. Reporting companies that were in existence before that date will have one year to file their initial reports, while reporting companies formed after that date will have 30 days to make their initial filing (31 C.F.R. 1010.380(a)).

For more information on the BOI Rule, see [Practice Note, Corporate Transparency Act Beneficial Ownership Reporting](#).

FinCEN has also commenced a rulemaking that will govern access to the registry by entities, including certain

government entities and financial institutions, but the proposed rule has not been finalized (Financial Crimes Enforcement Network, "Beneficial Ownership Information Access and Safeguards, and Use of FinCEN Identifiers for Entities," 87 Fed. Reg. 77,404 (Notice of Proposed Rulemaking, December 16, 2022)).

For more information on the implications for financial institutions of FinCEN's proposed rule governing access to its registry, see [Article, FinCEN's Proposed Rule on Access to the Beneficial Ownership Registry: Implications for Financial Institutions](#).

The final rulemaking implementing the CTA will make conforming changes to the beneficial ownership provisions of FinCEN's existing Customer Due Diligence Rule (CDD Rule), but that rulemaking has not yet begun (31 C.F.R. 1010.230). For more information on the CDD Rule, see [Practice Note, Commitment Letters Overview: Lending: Beneficial Ownership Regulation](#).

### Which entities are subject to the BOI Rule and what are the compliance requirements? What information must be reported?

Domestic and foreign reporting companies are required to comply with the BOI Rule. A reporting company is basically a legal entity, such as a corporation or LLC, that is formed or registered by making a filing with a secretary of state or any similar office (31 C.F.R. 1010.380(c)(1)). A reporting company is required to file an initial report providing general information about the company and identifying information about its beneficial owners (31 C.F.R. 1010.380(a)(1)). A beneficial owner is "any individual who, directly or indirectly, either exercises

substantial control over such reporting company or owns or controls at least 25 percent of the ownership interests of such reporting company” (31 C.F.R. 1010.380(d)).

Additionally, a reporting company formed after January 1, 2024 is required to provide information on its company applicants, basically the person making the filing that forms or registers the company and the person overseeing that person (31 C.F.R. 1010.380(e)).

Reporting companies are also required to file updated and corrected reports, as necessary (31 C.F.R. 1010.380(a)(2) and (3)).

For more information on the BOI Rule compliance requirements, see [Practice Note, Corporate Transparency Act Beneficial Ownership Reporting](#).

### What are some of the notable exemptions from the BOI Rule?

There are 23 exemptions from the definition of reporting company in the BOI Rule (31 C.F.R. 1010.380(c)(2)). These include exemptions for:

- Large operating companies.
- Banks.
- Credit unions.
- Depository institution holding companies.
- Money services businesses.
- Broker-dealers.
- Clearing agencies.
- Investment companies.
- Investment advisers.
- Other Exchange Act registered entities.
- Pooled investment vehicles.
- Subsidiaries of exempt entities, except money services businesses, pooled investment vehicles, entities assisting a tax-exempt entity, or an inactive entity.

The exemption for large operating companies is notable because it will exempt a sizeable number of companies that would otherwise have to file a report (31 C.F.R. 1010.380(c)(2)(xxi)). Under the BOI Rule, a large operating company is broadly defined as a company that:

- Employs more than 20 full time employees in the US.
- Has an operating presence at a physical office within the US.

- Filed in the previous year federal income tax returns demonstrating more than \$5 million in gross receipts or sales in the aggregate (including through other entities owned by the company).

The exemption for subsidiaries of exempt entities is also noteworthy as it will also exempt a large number of entities from compliance with the BOI Rule (31 C.F.R. 1010.380(c)(2)(xxii)).

### How does the BOI Rule differ from FinCEN’s existing CDD Rule?

The main difference between the BOI Rule and FinCEN’s existing CDD Rule is that the BOI Rule imposes legal obligations on legal entities that are not financial institutions, while the CDD Rule only imposes legal obligations on certain covered financial institutions, specifically banks, broker-dealers, mutual funds, futures commission merchants, and introducing brokers.

Other differences include that:

- The definition of beneficial owner in the BOI Rule is broader than the definition under the CDD Rule.
- There are more exemptions from the definition of reporting company in the BOI Rule than there are exclusions from the definition of legal entity customer in the CDD Rule (discussed further below).

At least until the CDD Rule is amended, financial institutions will be collecting beneficial ownership information from entities that will not be required to report this information to FinCEN under the BOI Rule.

While the BOI Rule will not impact financial institutions directly, certain financial institutions may access the registry to facilitate their compliance with the beneficial ownership requirements of the CDD Rule.

### How do you think the BOI Rule may impact loan transactions, including due diligence and legal opinions?

At this point, it is not known whether banks and other lenders will be required to access the registry to verify the identities of the beneficial owners of their legal entity customers but, in any case, it seems at least likely that some lenders that will have access to the registry will use it to do so.

The CTA requires a financial institution to obtain its customer’s consent to access their information in the

registry and financial institutions will need to implement processes to obtain this consent before they will be able to access it (31 U.S.C. 5336(c)(2)(B)(iii)). For new customers, this will likely be built into the onboarding process while, for existing customers, banks will need to develop procedures to obtain their customer's consent after the account is opened, for example, during a periodic refresh of the customer's information. In any case, it may be helpful for financial institutions to obtain permission from borrowers to access the registry to facilitate their compliance with the beneficial ownership requirements of the CDD Rule.

One practical issue that may arise concerns what steps a financial institution should take if it discovers discrepancies between the information it has been provided by its customer and the information that it obtains from the registry. These discrepancies can arise for a host of reasons and are not necessarily attributable to misconduct on the part of the customer or reporting company. However, it seems likely that, at a minimum, regulators will expect financial institutions that discover discrepancies to resolve them and document how they have done so in their records.

It is also likely that there will be circumstances where data is missing from the registry. One reason for this is the misalignment between the exceptions from the definition of reporting company in the BOI Rule and the definition of legal entity customer in the existing CDD Rule. As mentioned, the BOI Rule contains 23 exceptions compared with only 16 in the CDD Rule, and the CDD Rule does not contain a parallel exception for large reporting companies (31 C.F.R. 1010.380(c)(2) and 31 C.F.R. 1010.230(e)(2)). Therefore, at least until conforming amendments are made to the CDD Rule, missing data in the registry is likely to be a fairly common occurrence and, in these cases, financial institutions will need to use sources other than the registry to verify the identities of their customers' beneficial owners.

In situations where a financial institution discovers an apparent willful failure to file a report with FinCEN by a non-exempt reporting company, it should consider whether to file a suspicious activity report or take other action. Financial institutions may decide, as a matter of prudent risk management, to periodically query the registry to ensure that their customer information is up-to-date and accurate.

### **Do you think the BOI Rule may affect loan agreement representations and warranties and covenants or do you think parties can rely on existing loan agreement language relating to compliance with laws?**

Generally speaking, it is likely that the BOI Rule will impact loan agreement representations and warranties and covenants. However, this may not happen right away, as full implementation of the CTA (including changes to the beneficial ownership provisions of the CDD Rule) will likely impact the compliance obligations of both lenders and borrowers and could extend months and years beyond the effective date of the BOI Rule.

Once the CTA is fully implemented, lenders may want to:

- Consider their compliance obligations during the life of the loan.
- Build appropriate language into their loan agreements, for example, if the borrower is or becomes a non-exempt reporting company.

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