

Client Update

FinCEN Proposes Subjecting Funding Portals to BSA-AML Obligations

NEW YORK

Lee A. Schneider
lschneider@debevoise.com

David G. Sewell
dsewell@debevoise.com

Zila R. Acosta-Grimes
zracosta@debevoise.com

WASHINGTON, D. C.

Satish M. Kini
smkini@debevoise.com

Robert T. Dura
rdura@debevoise.com

On April 4, 2016, the Financial Crimes Enforcement Network (“FinCEN”) proposed to include funding portals, a type of limited purpose broker-dealer allowed to market securities relying on Regulation Crowdfunding, within the definitions of “broker or dealer in securities” and “broker-dealer” in the agency’s regulations implementing the Bank Secrecy Act (the “BSA”). If FinCEN’s proposal is adopted in a final rule, funding portals would have to comply with the same anti-money laundering (“AML”) regulations as any other broker-dealer registered under Section 15 of the Securities Exchange Act of 1934.

BACKGROUND OF REGULATION CF

On October 30, 2015, the Securities and Exchange Commission (“SEC”) adopted Regulation Crowdfunding, which regulates the offer and sale of securities through a new type of offering involving a general solicitation without SEC registration (“Regulation CF”).¹ Under Title III of the Jumpstart Our Business Startups Act (the “JOBS Act”), crowdfunding allows an issuer to raise equity or debt in a small offering open to all investors, but limits the total amount purchased by any investor.² Crowdfunding is a new method to raise money using the Internet by seeking small individual contributions from a large number of people. Regulation CF sets forth the regulatory apparatus that will govern both the issuers and the intermediaries in these offerings.³

¹ Regulation Crowdfunding codified as amended at 17 C.F.R § 200, 227, 232, 240 and 249 (2015) available at <http://www.sec.gov/rules/final/2015/33-9974.pdf>. See The SEC Hands out a Halloween Treat to Crowdfunding Supporters, Nov. 17 2015, available at <http://www.debevoise.com/insights/publications/2015/11/the-sec-hands-out-a-halloween-treat-to>.

² 15 U.S.C. § 77a et seq.

³ See The SEC Hands out a Halloween Treat to Crowdfunding Supporters, *supra*.

Regulation CF permits two types of intermediaries for crowdfunding raises: traditional broker-dealers and “funding portals.” Funding portals are essentially Internet-based platforms that facilitate crowdfunding offerings but are not permitted to engage in other securities intermediary activities without registering as a broker-dealer. As a securities intermediary, funding portals are subject to oversight by both the SEC and the Financial Industry Regulatory Authority (“FINRA”). Regulation CF will become effective May 16, 2016, and the forms enabling funding portals to register with the SEC became effective January 29, 2016.⁴

PROPOSED AML OBLIGATIONS FOR FUNDING PORTALS

One open question after the adoption of Regulation CF concerned the AML obligations of funding portals. In its final rule, the SEC chose not to impose AML obligations on funding portals, finding that it would be “more appropriate” for funding portals to work with other regulators “to develop consistent and effective AML obligations.”⁵

To ensure funding portals are subject to the regulations implementing the BSA, on April 4, 2016 FinCEN proposed to amend the definitions of “broker or dealer in securities” and “broker-dealer” (the “Amendments”) in its regulations implementing the BSA.⁶ In so doing, FinCEN indicated that funding portals raise at least the same degree of AML and terrorist financing risk as broker-dealers registered with the SEC and suggested they should be regulated as such.⁷

The consequence of this definitional change is that funding portals would be required to implement policies and procedures reasonably designed to achieve compliance with all BSA requirements currently applicable to broker-dealers. Under the BSA, broker-dealers must, among other things: (1) implement AML programs, (2) have in place policies and procedures to detect and file reports on suspicious activity, (3) establish customer identification programs and (4) have in place programs to report on currency transactions meeting certain dollar thresholds. The BSA program also must include books and records retention

⁴ Notice of Filing a Proposed Rule Change to Adopt the Funding Portal Rules and Related Forms and FINRA Rule 4528 (Oct. 22, 2015)
<https://www.sec.gov/rules/sro/finra/2015/34-76239.pdf>.

⁵ See 80 FR 71387, 71471 (Nov. 16, 2015).

⁶ Notice of Proposed Amendments of the Definition of Broker or Dealer in Securities, 81 Fed. Reg. 19086, 19088 (Apr. 4, 2016).

⁷ *Id.*

requirements as well as a prohibition on maintaining correspondent accounts for foreign shell banks.

FinCEN is seeking comments on its proposal. Among other questions, FinCEN has asked:

- Is the application of all BSA regulations currently covering brokers or dealers in securities to funding portals appropriate?
- Are there exceptions to the regulations that should be granted to funding portals? If so, why would any such exceptions be appropriate?

Comments on the proposal are due by June 3, 2016.

CONCLUSION

Earlier this year, we identified AML compliance as an important regulatory issue for Financial Technology companies to consider in their operations.⁸ FinCEN's proposed Amendments evidence this regulatory trend.

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Please do not hesitate to contact us with any questions.

⁸ Compliance Issues FinTech Firms (and FinTech Investors) Should Be Focused on in 2016, (Jan. 12, 2016), available at <http://www.debevoise.com/insights/publications/2016/01/compliance-issues-fintech-firms>.