Know Your Customers Regulations: What EB-5 Participants Should Know

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Any new commercial enterprise **(NCE)** that is an issuer of EB-5 securities **(EB-5 Issuer)** should understand and comply, as applicable, with the so-called "know your customer" **(KYC)** rules. Although the KYC rules principally apply to banks and other financial institutions, Issuers should not be surprised if their escrow bank imposes some of their obligations on them.

Under the KYC rules, banks and other financial institutions are subject to certain regulations promulgated by the Financial Crimes Enforcement Network **(FinCEN)**, a bureau of the Department of Treasury. One primary law that governs these banks is the Currency and Foreign Transactions Reporting Act of 1970 as amended by the PATRIOT Act of 2001.[1] This law, along with a set of affiliated laws, became known collectively as the Bank Secrecy Act **(BSA)**.[2] The BSA places several obligations on the part of financial institutions to ensure that its customers are not committing fraud, terrorism, or other similar crimes through their bank accounts.

Financial institutions' obligation to comply with FinCEN regulations may be categorized into two main components: Customer Identity Protection **(CIP)** and Customer Due Diligence **(CDD)**.

CIP is the "fact-checking" prong of the obligation.[3] Under CIP, financial institutions must essentially run a background check on potential new account holders.[4] They generally will collect information from the customer's driver's license or passport to ensure the identity of the individual.[5]

CDD concerns itself with monitoring customer account behavior. It deals more with tracking the customer's account use once the account is opened.[6] As part of CDD protocol, the financial institution must create a customer risk profile when the customer opens an account.[7] The factors that go into the profile are institution-specific; the institution may choose to include categories such as location of customer, type of business or employment of customer, and type of account.[8] The institution would also take into account new circumstantial information, as appropriate, that reflects on the customer's risk profile. For example, the institution would note if it saw that the customer was suspiciously sending wire transfers for no apparent reason, or rapidly changing its volume of transactions.[9]

Certain kinds of customers and customer circumstances may trigger enhanced due diligence standards, while others always do. According to the Federal Financial Institutions Examination Council **(FFIEC)**,[10] entities including nonresident aliens and foreign individuals, politically exposed persons, embassy, foreign consulate, and foreign mission accounts, and money services businesses may trigger higher standards based on how high they rate on the financial institution's customer risk profile.[11] On the other hand, customers such as individuals with high risk profiles and correspondent accounts of foreign banks that have been designated as non-cooperative with international anti-money laundering principles or procedures always trigger enhanced due diligence standards.[12] In any case where enhanced due diligence is necessary, the financial institution should impose stricter customer monitoring standards. For example, the institution should obtain more information when the customer opens their account, and then it should monitor the customer's activity more closely throughout its relationship with the institution.[13] Additional information that the institution should obtain includes source of funds and wealth, occupation or type of business (of customer or other individuals with ownership or control over the account), and location where the business customer is organized and where they maintain their principal place of business.[14]

1 Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016), https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf.
2 Id.
3 What is KYC and Why Does it Matter?, FIN, March 1, 2019, https://fin.plaid.com/articles/kyc-basics/.
4 Id.
5 Id.
6 Id.
7 Customer Due Diligence – Overview, FFIEC, pg. 1, https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf.
8 See What is KYC and Why Does it Matter?, FIN, March 1, 2019, https://fin.plaid.com/articles/kyc-basics/ and Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016), https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf.
9 Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016), https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf.
10 FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the examination of financial institutions by various federal agencies, and to make recommendations to promote uniformity in the supervision of such institutions. In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. About the FFIEC: Mission, State Liaison Committee, FFIEC, https://www.ffiec.gov/about.htm.
11 See Customer Due Diligence – Overview, FFIEC, pg. 5, https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf and BSA/AML Manual: Persons and Entities, FFIEC, https://bsaaml.ffiec.gov/manual/PersonsAndEntities/01.
12 Global Financial Crimes Full Report Country Guide: United States, PWC, pg. 13, https://citt.pwc.de/tools/; CFR § 1010.610(c)(2) (2018).
13 Customer Due Diligence – Overview, FFIEC, pg. 5, https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf
14 Id.

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If a financial institution does not perform adequate FinCEN due diligence, penalties can be severe. FinCEN regulations provide for civil penalties of up to $1,000 for recordkeeping violations, and for reporting violations, regulations provide for up to the greater of the amount involved in the transaction (up to $100,000) or $25,000.[15] As for criminal penalties, FinCEN regulations provide for fines of up to $250,000 or imprisonment of up to 5 years or both for willful violations of KYC requirements, and the penalties are twice as severe if the violation was committed while violating another US law or if it was committed as part of a pattern of criminal activity.[16]

Financial institutions are also subject to regulations set by the Office of Foreign Asset Control **(OFAC)**, a bureau of the Department of Treasury. OFAC and its attendant regulations make sure that US businesses, including financial institutions, comply with international economic sanctions. OFAC places compliance requirements similar to FinCEN's obligations on financial institutions. When a financial institution runs its CIP and CDD checks on new customers, it should simultaneously check each customer's risk with respect to OFAC.[17] The institution should compare new customer accounts with OFAC lists to make sure that the customer is not, and is not related to, a sanctioned individual, entity, or country.[18] Factors that would increase a customer's risk with respect to OFAC include the customer's involvement with international funds transfers, nonresident alien accounts, and foreign correspondent bank accounts.[19]

EB-5 Issuers are clearly impacted by the FinCEN and OFAC regulations because by necessity they have foreign investors as members or limited partners. An EB-5 Issuer that opens a bank account would need to supply contact, business, and transactional information to their financial institution as part of compliance with such regulations. However, those new to EB-5 often find out that the number of financial institutions willing to hold EB-5 deposits is extremely limited. Of the over 6,000 banks in the United States, less than ten will accommodate EB-5 deposits consistently. Perhaps for many familiar with EB-5 this process does not appear significant since the banks willing to work with EB-5 have already agreed to run the KYC process. Certainly this is a service that NES Financial, as escrow administrator in such deals, seamlessly works behind the scenes to ensure that the escrow agent and bank are able to support the unique nature of EB-5 escrow deposits. If, however, there is no financial institution serving as escrow agent or escrow bank, then the KYC obligations will squarely impact the NCE or its law firm if it serves as escrow agent. Given the current regulatory environment and the concerns that many financial institutions have with serving as the escrow bank, NCE's and their law firms may have to take a more active role in their financial institutions' compliance with FinCEN regulations. In recent years, FinCEN regulations have become ever more expansive and comprehensive.[20] Given the heavy burden on financial institutions, such institutions may pass down compliance requirements onto their customers.[21] For example, banks may charge law firms with vetting those sending money into the firms' escrow accounts instead of the bank itself. Law firms, regardless of whether they are in the EB-5 space, should be prepared to take on these responsibilities and must understand the attendant risks.

15 31 CFR § 1010.820(c), (f) (2018).
16 31 CFR § 1010.840(b), (c) (2018).
17 Office of Foreign Assets Control – Overview, FFIEC, pg. 138, https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ofac_sec_frb_080106.pdf.
18 Id.
19 Id. at 139.
20 What is KYC and Why Does it Matter?, FIN, March 1, 2019, https://fin.plaid.com/articles/kyc-basics/.
21 Id.