

# Legally Speaking – What's Going On In Community Banking Today

**Sherry Dreisewerd, Esq. (St. Louis)**  
**Elizabeth Fast, Esq. (Kansas City)**  
**Rodney Nichols, Esq. (Springfield)**

**May 2018**



**SpencerFane**

# Outline of Presentation

- Elizabeth

- Beneficial ownership rules effective 5/11/18
- Cybersecurity and data breach situations

- Rod

- Future advance deeds of trust and other lien perfection issues
- Recent issues with participation agreements

- Sherry

- New Missouri receivership statute

# Beneficial Ownership Rules



SpencerFane<sup>®</sup>

# Beneficial Ownership - Overview

- Effective on July 11, 2016 with mandatory compliance deadline of May 11, 2018
- Rule covers all new “accounts” (includes loans, safe deposit boxes, etc)
- Requires banks to establish and maintain written procedures reasonably designed to identify and verify beneficial owners of legal entity customers
- The requirements are not retroactive but do require recertification at the time of **each** new account opening (i.e., renewals of CDs and loans)

# Beneficial Ownership – Legal Entities

## **Covered Entities**

- Corporations
- Limited Liability Corporations
- Limited Partnerships
- General Partnerships
- Business Trusts
- Any Entity Created by Filing Public Document with Secretary of State or Similar Office

## **Exempted Entities**

- Natural Persons
- Sole Proprietorships
- Unincorporated Associations
- Trusts – Not Created by State Filing
- Government Entity
- Publicly Traded Company
- SEC Registered Company
- Financial Institution

# Beneficial Ownership – 5 Key Elements

- Identify and verify the identity of your legal entity customers (Existing CIP Procedures)
- Identify and verify the identity of beneficial owners with 25% or more equity interest of your legal entity customers (New)
- Identify at least one “control person” for the legal entity customer (New)
- Understanding nature & purpose of customer relationships (Now Mandated)
- Conduct ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions (Now Mandated)

# Ownership & Control Prongs

- Two Prongs:
  - Ownership Prong – List each individual who, directly or indirectly, owns 25% or more of the equity interests of a legal entity customer (could be 0 to 4 people)
  - Control Prong – List one individual with significant responsibility to control, manage, or direct the legal entity customer (i.e., CEO, CFO, Managing Member, President, VP, Treasurer)

# Beneficial Ownership Certification

- Bank may rely on the percentage of ownership in the legal entity customer provided by person at account opening, as long as there is no reason to question the reliability of the information
- A sample certification for collecting the Control and Ownership prong information is provided in Appendix A of the rule.



# APPENDIX A TO § 1010.230

## Certification Regarding Beneficial Owners Of Legal Entity Customers

### I. GENERAL INSTRUCTIONS

#### What is this form?

To help the government fight financial crime, Federal regulation requires certain financial institutions to obtain, verify, and record information about the beneficial owners of legal entity customers. Legal entities can be abused to disguise involvement in terrorist financing, money laundering, tax evasion, corruption, fraud, and other financial crimes. Requiring the disclosure of key individuals who own or control a legal entity (i.e., the beneficial owners) helps law enforcement investigate and prosecute these crimes.

#### Who has to complete this form?

This form must be completed by the person opening a new account on behalf of a legal entity with any of the following U.S. financial institutions: (i) a bank or credit union; (ii) a broker or dealer in securities; (iii) a mutual fund; (iv) a futures commission merchant; or (v) an introducing broker in commodities.

For the purposes of this form, a legal entity includes a corporation, limited liability company, or other entity that is created by a filing of a public document with a Secretary of State or similar office, a general partnership, and any similar business entity formed in the United States or a foreign country. Legal entity does not include sole proprietorships, unincorporated associations, or natural persons opening accounts on their own behalf.

#### What information do I have to provide?

This form requires you to provide the name, address, date of birth and Social Security number (or passport number or other similar information, in the case of foreign persons) for the following individuals (i.e., the beneficial owners):

- (i) Each individual, if any, who owns, directly or indirectly, 25 percent or more of the equity interests of the legal entity customer (e.g., each natural person that owns 25 percent or more of the shares of a corporation); and
- (ii) An individual with significant responsibility for managing the legal entity customer (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, or Treasurer).

The number of individuals that satisfy this definition of "beneficial owner" may vary. Under section (i), depending on the factual circumstances, up to four individuals (but as few as zero) may need to be identified. Regardless of the number of individuals identified under section (i), you must provide the identifying information of one individual under section (ii). It is possible that in some circumstances the same individual might be identified under both sections (e.g., the President of Acme, Inc. who also holds a 30 percent equity interest). Thus, a completed form will contain the identifying information of at least one individual (under section (ii)), and up to five individuals (i.e., one individual under section (ii) and four 25 percent equity holders under section (i)). The financial institution may also ask to see a copy of a driver's license or other identifying document for each beneficial owner listed on this form.

## II. CERTIFICATION OF BENEFICIAL OWNER(S)

Persons opening an account on behalf of a legal entity must provide the following information:

a. Name and Title of Natural Person Opening Account:

---

b. Name and Address of Legal Entity for Which the Account is Being Opened:

---

c. The following information for each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25 percent or more of the equity interests of the legal entity listed above:

Name	Date of Birth	Address (Residential or Business Street Address)	For U.S. Persons: Social Security Number	For Foreign Persons: Passport Number and Country of Issuance, or other similar identification number <sup>1</sup>

*(If no individual meets this definition, please write "Not Applicable.")*

<sup>1</sup> In lieu of a passport number, foreign persons may also provide an alien identification card number, or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

d. The following information for one individual with significant responsibility for managing the legal entity listed above, such as:

- An executive officer or senior manager (e.g., Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, Treasurer); or
- Any other individual who regularly performs similar functions.  
(If appropriate, an individual listed under section (c) above may also be listed in this section (d)).

Name	Date of Birth	Address (Residential or Business Street Address)	For U.S. Persons: Social Security Number	For Foreign Persons: Passport Number and Country of Issuance, or other similar identification number <sup>1</sup>

<sup>1</sup> In lieu of a passport number, foreign persons may also provide an alien identification card number, or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

I, \_\_\_\_\_ (*name of natural person opening account*), hereby certify, to the best of my knowledge, that the information provided above is complete and correct.

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Legal Entity Identifier \_\_\_\_\_ (Optional)

# Beneficial Ownership – “5<sup>th</sup> Pillar”

- Rule amends BSA/AML program requirements to explicitly require banks to implement and maintain appropriate risk-based procedures for conducting ongoing customer due diligence to include:
  - Understanding the **nature and purpose** of the customer relationship
    - What business does the customer engage in?
    - What is the purpose of the account?
  - Conduct **ongoing monitoring** to identify and report suspicious transactions and, on a risk basis, to maintain and **update customer information**
    - What is the expected frequency and amount of transactions?
    - What products does the customer intend to use in connection with the account?

# Cybersecurity and Data Breach



SpencerFane™

# Investigating Security Incidents

- Bank's response program must contain procedures for:
  - Accessing nature and scope of an incident and identifying what types of customer information was accessed
  - Notifying bank's primary federal regulator if involves "sensitive customer information"
  - Consistent with SAR regulations, filing a timely SAR, and in situations involving federal criminal violations requiring immediate attention, promptly notifying law enforcement
  - Taking steps to contain and control the incident to prevent further unauthorized access to or use of customer information
  - Notifying customers when warranted

# Investigating Security Incidents (cont.)

- Bank must provide notice to customers of any incident of unauthorized access to sensitive customer information if, at the conclusion of a reasonable investigation, bank determines that misuse of the information has occurred or it is reasonably possible that misuse will occur
  - “Sensitive customer information” means customer’s name, address or telephone number in conjunction with customer’s Social Security number, driver’s license number, account number, credit or debit card number, or a PIN or password that would permit access to customer’s account
  - “Misuse” normally refers to fraudulent account activity or identity theft

# Are Your Bank's Security Procedures Sufficient?

- Bank must use effective methods to authenticate identity of person and the methods employed must be commensurate with the risk associated with the product offered and the need to protect sensitive customer information
- Good news: Bank isn't required to use the "best" or "top of the line" security procedures



# Are Your Bank's Security Procedures Sufficient? (cont.)

- Layered security programs use different controls at different points in a transaction process:
  - Fraud detection system that considers history and behavior
  - Use of out-of-band verification
  - Use of “positive pay” and other techniques to limit transactions
  - Policies and practices for addressing devices identified as potential problems
  - Enhanced control over changes to account maintenance activities
  - Enhanced personal education

# Future Advance Deeds of Trust

Payoff: Maximum Lien or Secured Debt?  
Grisham v. Mission Bank



# Background

- Grisham granted Mission Bank five separate Deeds of Trust on residence and acreage
- Many of the Deeds of Trust contained cross-collateralization clauses
- Deeds of Trust had combined maximum obligation limits of \$1.25MM
- Grisham defaulted on various loans and bank commenced foreclosure on 5<sup>th</sup> Deed of Trust which had maximum lien of \$500,000
- Grisham received offer to buy property for \$1.35MM

# The Payoff Request

- Grisham requested payoff letter in connection with potential sale of property
- Bank's counsel sends letter to Grisham stating "...as referenced on the face amount of the deed of trust being foreclosed, the principal amount of the obligations secured is \$500,000"
- Grisham offered to tender \$500,000 in exchange for release of the Deed of Trust and cancelation of the sale
- Bank did not accept proposal and asserted that the entire debt of over \$3MM must be paid

# Bank Foreclosures / Borrower Sues

- Bank concludes sale and is successful bidder
- Grisham sues claiming bank demanded payment of more than combined maximum lien amount on Deeds of Trust
- Trial court ruled in favor of Grisham; Mission Bank appealed

# Court of Appeal Reverses/Explains Legal Effect of Maximum Lien Amount

- “Both Grisham’s arguments and the trial court’s judgment evidence a fundamental misunderstanding below regarding the operation of future advance deeds of trust”
- 5th Deed of Trust secured the \$500,000 Note plus all other obligations of Grisham
- Payment of \$500,000 would not require release of 5<sup>th</sup> Deed of Trust by bank
- Payment of the combined maximum lien amounts of the Deeds of Trust would not require release by bank
- “[Grisham’s argument was also premised on a misunderstanding of the nature of the secured debt itself insofar as she relied upon the maximum lien provision as a limit of liability for herself as the debtor. But as discussed supra, that is not the purpose or effect of the maximum lien provision.”
- Maximum lien amount intended for benefit of junior lien holders
- Bank could have applied payments received first to unsecured obligations (e.g. overdraft amount), then to secured debts
- Bank entitled to payment of ALL debts owed by Grisham to secure release of Deeds of Trust; not merely \$1.25MM
- Bank did not wrongfully foreclose or commit any other illegal act in connection with payoff amount demanded

# Participation Agreements



SpencerFane<sup>®</sup>

# Participation Agreements – Sale or Secured Borrowing?

- FASB 860-10-40 - Derecognition
- Surrender of control over financial assets
- Transfer of financial asset accounted for as a sale only if:
  1. The transferred asset is isolated from the transferor; put presumptively beyond the reach of the transferor and its creditors;
  2. The transferee has the right to pledge or exchange the asset it received and no condition (i) constrains the transferee from taking advantage of such right and (ii) provides more than a trivial benefit to the transferor; AND
  3. The transferor does not maintain “effective control” over the asset.
- “Effective Control” includes, but is not limited to ANY of the following:
  1. An agreement that both entitles and obligates the transferor to repurchase or redeem the transferred asset before its maturity;
  2. An agreement, other than through a cleanup call that provides the transferor with BOTH of the following: (i) the unilateral ability to cause the holder to return specific financial assets and (ii) a more than trivial benefit attributable to that ability;
  3. An agreement that permits the transferee to require the transferor to repurchase the transferred asset at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them



# Participation Agreements – Sale or Secured Borrowing?

- Restrictions on ability to pledge or assign may be in the form of contractual provision in the transfer agreement, or because the transferee is constrained due to other factors; transferor must “look through” constrained entity for restrictions
- Condition imposed by transferor that constrains transferee’s right to pledge or exchange is presumed to provide more than a trivial benefit to the transferor
- Transferor cannot benefit from a constraint if it is unaware at the time of the transfer that the transferee is constrained
- If transferor has right to require transferee to sell the asset back to the transferor, or vice versa, effective control has not been relinquished and transfer not accounted for as a sale
- Provision requiring transferee to return transferred asset to transferor following a borrower default is permissible for sale accounting

# Participation Agreements – Sale or Secured Borrowing?

- If transferor has the right to terminate the transfer agreement for any reason, and the result would be a return of the transferred asset to the transferor, effective control has not been relinquished and not accounted for as a sale
- Restriction on ability to pledge or exchange without transferor's consent is permissible provided that transferor's consent cannot be unreasonably withheld
- Don't assume that platform participation agreements are suitable for sale accounting purposes
- Look closely at (i) provisions relating to termination of agreement and (ii) provisions governing the transferee's ability to pledge or exchange the interest
- Possible negative accounting consequences for the transferor if the transfer does not qualify for sale accounting; treated as a secured borrowing by the transferor

# Auto Dealer Lien Perfection



SpencerFane<sup>®</sup>

# Auto Dealer Lien Perfection – Forget about the Notice of Lien

- Standard method to perfect lien on automobile is through notation of lien on title; filing Notice of Lien with Department of Revenue
- Different method of perfection required when the debtor is a dealer of automobiles
- “Perfection of a security interest in the inventory of a person in the business of selling goods of that kind is governed by the normal perfection rules, even if inventory is subject to a certificate-of-title statute. Compliance with a certificate-of-title statute is both unnecessary and ineffective to perfect a security interest in inventory . . . Thus a secured party who finances an automobile dealer that is in the business of selling and leasing its inventory of automobiles can perfect a security interest in all automobiles by filing a financing statement but not by compliance with a certificate-of-title statute.” §400.9-311, RSMo. and Official Comment 4.

# Auto Dealer Lien Perfection – Forget about the Notice of Lien

- Purchase-money security interest; lien priority governed by §400.9-324, RSMo.
- Purchase-money security interest in inventory may require additional step
- If other secured creditor has lien on all of debtor's inventory, written notice must be sent to such creditor advising that a purchase-money security interest in debtor's inventory is being taken and the specific inventory must be described
- Notice must be RECEIVED by other secured creditor before the debtor receives possession of the inventory being financed
- Notice should be sent by certified mail or other method allowing delivery to be proven

# Applications and Advantages of the Missouri Commercial Receivership Act (MCRA) (RSMO 515.500 *et seq.*)



# Before the MCRA

- Prior to enactment of the MCRA in 2016, receivership cases in Missouri courts were administered under a 155-word statute
- *“The court or any judge thereof in vacation, shall have the power to appoint a receiver whenever such appointment shall be deemed necessary, whose duty it shall be to keep and preserve any money or other thing deposited in court, or that may be subject of a tender, and to keep and preserve all property and protect any business or business interest entrusted to the receiver pending any legal or equitable action concerning the same.”*

# Before the MCRA

- Lack of guidance and uniform standards for appointment of a receiver and administration of a receivership estate meant unpredictable results across Missouri courts
- Courts were forced to deal with a myriad of issues, ranging from due process protections to day-to-day oversight of an operating company, including employment, insurance and regulatory issues



# Overview of the MCRA

- MCRA was enacted August 28, 2016 as bar-sponsored legislation
- Provides clearer framework for effective and efficient administration
- Codifies the ability to seek appointment of receiver as a stand-alone claim

# Overview of the MCRA

- Provides for two categories of receivership: limited and general
- Sets forth requirements for a party to serve as a receiver
- Provides for a proof of claim process and priorities of distribution

# Overview of the MCRA

- MCRA provides clear statutory guidance for receivers (e.g. hiring of accountants and other professionals)
- Sets forth powers and duties of receivers, including ability to sell property, establish control over non-Missouri assets, and requirement to correspond with taxing and regulatory authorities

# Overview of the MCRA

- MCRA may lead to an increase in the number of receiverships
- Banks may be required to understand and participate in the process to a much greater degree than in the past

# Applications and Advantages of the MCRA

## **Case 1: Medical Receivables**

- Bank with defaulted credit owning from related companies providing medical/therapeutic services, portions of which are paid by Medicaid
- Under prior law, and due to Federal law and regulations, attachment, levy and direct collection of such receivables was (is) generally barred
- Under the MCRA, the borrower was ordered to sweep its accounts and transfer funds to an account set up by the receiver, thereby enabling the bank to receive such funds in real time

# Applications and Advantages of the MCRA

## **Case 2: National for profit college with online presence**

- Under prior law, the ability to sell assets free and clear of liens was unclear and sometimes difficult to achieve
- Under the MCRA, due to clarity of provisions providing for free and clear sale, entity was able to maintain operations during receivership and market and sell assets as a going concern, maximizing value for creditors. The ability to achieve a free and clear sale and to shape the sale agreement to include valuable assets without burdening the sale with assets lacking in value helped obtain a higher purchase price than otherwise would have been available

# Applications and Advantages of the MCRA

## **Case 3: Mining and mineral processing business**

- In a situation where an abandoned mine owned by a non-responsive owner/operator sat idle for years, the MCRA was used to transition the mine and related properties to a receiver, to pay back taxes, and to position the mining operation for future reanimation and operations
- Under prior law, the steps and requirements to achieve the various parts of this large and complicated transaction were unclear and may not have been possible. But, with statutory clarity and efficient case administration, the property now may be returned to operating status and may yield significantly improved returns for creditors

# Applications and Advantages of the MCRA

## **Case 4: MCRA vs. receiverships under prior law**

- Under prior law, receivership was used primarily as a means for a lender to take control of rent collection and management of a commercial property through a receiver, and position the property for sale
- Under MCRA, the same can be accomplished with improvements to the process and speed at which such turnaround and collection efforts may be accomplished
- Lower cost, greater certainty, higher returns



# Thank You

**You are welcome to contact:**

**Sherry Dreisewerd**

**[sdreisewerd@spencerfane.com](mailto:sdreisewerd@spencerfane.com)**

**Elizabeth Fast**

**[efast@spencerfane.com](mailto:efast@spencerfane.com)**

**Rodney Nichols**

**[rnichols@spencerfane.com](mailto:rnichols@spencerfane.com)**

**Spencer Fane LLP**

**Phone: (800) 526-6529 toll free**