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The importance of digital transformation for state registries

As a foundation of the United States' economic independence, The Act Relative to Incorporations for Manufacturing Purposes passed by New York state legislature in 1811, created the precedent that State Secretaries are responsible for maintaining registries of corporate information.

The Act of 1811 spurred economic development and within seven years, 129 manufacturing firms had incorporated in New York. Today, more than 200 years later, businesses are boosting their productivity by automating processes and linking these with flows of information in digital formats. State registries are less advanced in their own transformations and information they manage is not always available in digital format. Over the last century supply chains have grown longer, and company ownership structures have become more complex. The imperative to give publicly available access to information about the individuals who directly benefit from their ownership and control of corporations has never been greater.

Digital technologies create the opportunity for state registries to become active participants in the global information economy and spur economic success for American companies in the 21st century.

The regulatory landscape

The Bank Secrecy Act (BSA) is the primary US anti-money laundering regulation applicable to both banking and non-banking financial institutions and has been amended to incorporate certain provisions of the USA PATRIOT Act to detect deter and disrupt terrorist financing networks. Recent major updates include the Anti-Money Laundering Act (AMLA) of 2020 and the Corporate Transparency Act. These updates are directing FinCEN to develop a centralized beneficial ownership registry by 2023 following input from relevant stakeholders.

The recent release of the Pandora Papers highlighted the negative public reaction when beneficial ownership is not transparent as part of standard Know Your Customer (KYC) onboarding processes. Currently, the difficulty in accessing a publicly available centralized beneficial ownership registry implies a veil of secrecy and privilege available only to the rich and famous – that they are trying to hide their illicit wealth from corrupt activities. The most recent example is the impeachment of the President of Chile due to a controversial mining deal exposed through the Panama Papers. Other notable world leaders called out include former British Prime Minister Tony Blair, the King of Jordan and presidents of Ukraine, Kenya and Ecuador. Negative press has resulted, irrespective of the legality of their actions when using opaque, offshore registry firms, designed to obscure the identity of company owners.

What is KYC and why it is important

The BSA requires banks to establish a process to verify the identity of customers, including the individuals who benefit from ownership. KYC requires that banks evaluate the risks of illegal activity arising from their business relationships with customers.

Registries' role in open economies

Our global networked economy is characterized by supply chains that span multiple continents and countries to source and supply goods and services, and by corporate ownership structures that span multiple continents and countries, such that a company operating in one country, may be owned and controlled by individuals living in a different jurisdiction.

Government regulations require companies to publish their business and financial information in the public domain. As the primary source of information about companies based in their state, registries are unrivaled as trusted sources required by multiple parties within the broader economy.

As Larry Fink, CEO of BlackRock observed in his 2021 letter to CEOs:

> **Over the course of 2020, we have seen how purposeful companies, with better environmental, social, and governance (ESG) profiles, have outperformed their peers.**

An increasingly important aspect of ESG in the financial sector is that banks and other financial institutions observe the spirit of regulations imposed by the Federal Government to protect the nation and its economy against the twin threats of money laundering and terrorist funding. These regulations oblige banks to regularly undertake a process of KYC due diligence. Access to information registered by companies about themselves is fundamental to KYC. State registries are increasingly important as enablers of good business which drives a vibrant economy.

The information troves within state registries enable economic growth for diverse commercial sectors and provide employment opportunities and funding for a variety of social services.

The types of data needed from registries in KYC

State registers contain a wealth of corporate information, including:

- Entity name
- Type of entity (Corp/LLC/LP)
- Status (is the registration active or inactive)
- Date entity filed
- Name of registered agent
- Registered address
- Principal (owner)
- Historical information, such as prior names.

Additionally, some states collect socio-economic data, such as the number of employees and the line of business.

From an operational perspective, the due diligence work of KYC includes researching company data to identify beneficial owners, establishing whether these are politically exposed persons (PEPs) and screening the company and its owners against sanctions lists. Additionally, a KYC business process must document the results of this research and create evidence that KYC has been undertaken in line with a bank's risk policy.

Registry data - adding value to the KYC process

Company information managed in state registries is fundamental to KYC. However, registries are not the sole source of information. Banks can subscribe to information services from intermediary companies which aggregate data from registries and other sources. These services are invaluable contributors to a burgeoning information economy. However, state registries are unique in being primary sources of information about companies as filed by those responsible in law from within those companies. Registries have unmatched credibility for KYC.

Companies constantly evolve and change, requiring that they update information in registries. It is incumbent on those responsible for KYC that they base risk decisions on up-to-date information. As primary sources, registries are uniquely positioned to supply up-to-date information.

Unintended economic consequences of outdated state registers

Tightening of anti-money laundering regulations by Federal Government creates additional work for banks and other financial institutions. To remain competitive, these companies must operate their KYC processes as efficiently as possible, and this means replacing manual work with automated digital workflows.

When a state registry only offers either paper documents or electronic PDFs, banks must abandon their preferred digital workflows and employ KYC analysts to read documents to find facts material to assessing the risk, that a corporate customer might exploit a business relationship to commit financial crime. This enforced operational inefficiency creates unnecessary costs and inevitably slows service provision to prospective customers.

When a state offers only web access to its register, a bank's KYC team must undertake manual searches and then copy data from webpages into the bank's KYC system. Copying data is prone to error, the industry accepts an error rate of 7% as normal. To rectify transcription errors, banks must employ additional resources to check the work of KYC analysts. When banks are forced to access registers via webpages, KYC operations suffer from low productivity creating unnecessary expense which damages the company's commercial standing.

To reduce KYC costs imposed by web access, banks will attempt to automatically "read" websites using screen-scraping technologies. These automated web bots generate load and costs on server infrastructure; to minimize these registries employ defensive technologies that resist scraping. This war between technologies obscures a larger, and economically more significant dynamic. The Federal Government obliges the nation's banks to undertake KYC, and state registries fulfill a critical informational role in the work of KYC.

To fulfill this role requires that state registries embrace the digital imperative and make corporate information filed in their registers publicly accessible, at speed and at low cost. Not doing so hampers the best efforts of America's banks to fulfill their anti-money laundering obligation at commercially realistic costs.

To become part of a digital, connected information economy, requires states to offer access to the databases supporting their registers, by adopting application programming interfaces (APIs). APIs allow system-to-system integration, with the high data integrity and performance required by the nation's banks, as they undertake digital transformation of their operations necessary to remain competitive.

A national perspective

The Federal Government is opening its resources to the broader economy to inform citizens and the nation from primary sources of information and to encourage innovation based on trustworthy data. This December 2020 report[1], lists 103 departments and agencies which have made information publicly accessible. One agency alone, General Services Administration, has published 27 APIs.

Embracing the digital imperative

Across states, there is wide variation in degrees of access to corporate data. States operating digital registries, publicly accessible via API, demonstrate the way forward. To improve accessibility of registers under their control, State Secretaries can consider taking the following actions:

1. Collect new corporate data in digital format
2. Convert existing records on active corporations to digital format
3. Verify corporate filings
4. Make access to the register publicly available via API
5. Open the register to give free, self-service access to citizens and occasional users
6. Charge business customers for content searches
7. Define and publish service level agreements (SLAs)
8. Offer business customers a push subscription service

If you would like to discuss this in more detail please get in touch.

1 https://apievangelist.com/2020/12/27/taking-a-fresh-look-at-apis-across-all-the-united-states-federal-agencies/

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w encompasscorporation.com
e info@encompasscorporation.com
a 1411 Broadway, New York, NY, 10018

New York • London • Singapore • Amsterdam • Sydney • Glasgow • Belgrade