DUE PROCESS
INSTITUTE

July 19, 2019

The Honorable Mark R. Warner
Committee on Banking, Housing & Urban Affairs
703 Hart Senate Office Building
Washington, DC 20510

Re: Requested Commentary on draft legislation (ILLICIT CASH Act)

Dear Senator Warner:

On behalf of the Due Process Institute, I write to express our concerns regarding certain provisions of the discussion draft of the "Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings" (or ILLICIT CASH) Act. We appreciate your request for commentary before the bill is formally introduced and hope that you consider the following issues before proceeding.

Section 401: Relying on Vague Terms to Create New Federal Crimes for First-Time Paperwork Violations is Unwise

Section 401 of the draft legislation would require people who form or already own small businesses and certain nonprofits to submit extensive personal, financial, and business-related information to the government's Financial Crimes Enforcement Network (FinCEN). Similar legislative efforts to prevent crime by trying to "follow the money" and disclose "beneficial owners" have already been introduced and likely have the best intentions in mind. However, a number of organizations from across the political spectrum have raised serious concerns with certain provisions of such proposals and we hope that you do not move forward with including this section in any introduced legislation until these issues are adequately addressed.

First, and importantly, numerous key terms in Section 401 are not adequately defined. For example, the current definition of "beneficial owner" includes anyone who "directly or indirectly" exercises substantial control or receives substantial economic benefit from an entity. But what does it mean to indirectly control an entity? The draft bill only partially defines phrases like "substantial control" or "substantial economic benefit" in the statute and instead leaves the task of creating or refining these definitions to regulators. Given that these definitions will be a critical part of determining who faces criminal liability (including jail time), leaving these phrases undefined by Congress fails to provide adequate notice regarding what constitutes criminal conduct and violates due process. By leaving the important task of defining key terms to regulators, Congress also subjects the law to change at the whim of a shifting executive.

This lack of clarity has very serious consequences when a bill would create multiple new federal criminal laws that do nothing but increase this nation's overreliance on criminalization as a cure for every problem. Vague or overly broad statutory text leaves people vulnerable to unfair criminal investigations and prosecutions. Furthermore, the beneficial ownership disclosure rules in this draft legislation exempts most large entities with the compliance teams necessary to help them navigate new and burdensome requirements. Determining what is to be reported, when, and by whom, in a complex regulatory scheme is difficult. However, large corporations are exempt—

leaving the reporting burdens solely to small or independent businessowners as well as many nonprofits. Compounding this problem, these new disclosure requirements would apply not only to newly formed entities but also to those that have already been in existence—yet a small businessowner (even a first-time offender) who fails to comply with any aspect of the requirements could face a prison sentence, as might a non-profit organization that inadvertently fails to meet all of the requirements to qualify for an exemption. These kinds of requirements easily set traps for honest people trying to faithfully comply with complex laws, particularly owners who lack experience or significant funds and volunteer-based nonprofits also lacking in funds and expertise to retain sophisticated business lawyers who can help them.

Section 401 does contain a provision setting forth civil financial penalties for certain undefined "de minimis" violations but it is not clear whether those are in addition to potential criminal penalties (such as imprisonment) or if the drafters intended these financial penalties to be *in lieu of* criminal prosecution for de minimis violations. Pursuing civil penalties for first-time and/or de minimis offenses would be a significant improvement to this type of proposal.

Unfortunately, Section 401 would permit beneficial ownership information to be shared with local, Tribal, State, or Federal law enforcement under nearly any circumstances where they may assert a law enforcement purpose. The receiving agency may then use that information, without limitation, for any other law enforcement, national security, or intelligence purpose. The bill should permit FinCEN to disclose beneficial ownership information only when presented with a warrant based on probable cause. Without a clear standard limiting information disclosure, there would be few if any limits on the sharing of this information. Search warrants based on probable cause are the standard for obtaining information in criminal investigations and it would be reasonable to require them in this context. Moreover, the receiving law enforcement agency should be prohibited from disclosing the information except to the extent necessary in the course of the investigation or legal proceedings in which it was requested. The use of the information should also be limited to the particular investigation for which it was requested. Currently, the draft bill contains none of these basic safeguards.

Creating criminal penalties for paperwork errors will not prevent money laundering or terrorism, which are already crimes. To support the criminalization of this reporting requirement, you would have to accept the premise that those engaging in such crimes—and who have the intention of engaging in such crimes while "hiding behind" a legal entity to go unnoticed—would comply with any legal requirement to disclose themselves. Meanwhile, those attempting to comply in good faith would be providing personal identifiable information to government entities that may then share them with other government entities with little meaningful assurance that their privacy will be properly protected. The draft would impose criminal penalties, including jail time, on small businesses that fail to meet compliance requirements with no real indication that such requirements would curtail international money laundering cartels. The truth is: there are already hundreds of federal criminal laws on the books, along with a wide swath of powerful investigative tools and authorities, that the government can use to adequately address criminal conduct. To create new federal crimes in connection with this kind of reporting disclosure is an unnecessary step in the wrong direction. No matter how well-intentioned, this kind of proposal bears no real relation to combatting terrorism or money laundering and instead eliminates a significant amount of personal and financial privacy. And, on that score, the proposal fails to adequately address how all of the personal and financial information disclosed to, and collected by, the government will be used solely for legitimate purposes or how privacy interests will be protected. Without meaningful revision, the draft language leaves too much personal information vulnerable to disclosure. These concerns should be addressed before introduction.

Use of Potential Biased Software to Monitor Transactions with No Privacy or Constitutional Protections

Next, Section 301 of the ILLICIT CASH Act would amend the Bank Secrecy Act to allow FinCEN to begin to utilize software programs to monitor financial transactions. The intent is to use algorithmic analysis to identify risky transactions for further investigation. However, it is unclear how the pilot software, or its results, would be used in criminal investigations.

Also, the draft legislation does not require FinCEN to publicly disclose information about the software/algorithms that could be used to peruse the personal information of millions of Americans. In other circumstances, similar automated software has been shown to amplify pre-existing enforcement biases due to the reliance on self-reported law enforcement data that may not have legitimate value in assessing risk and identifying potentially unlawful transactions.

The use of this type of broad surveillance technology could have the effect of sweeping large numbers of innocent individuals into unwarranted criminal investigations and could facilitate fishing expeditions by the government that are not authorized by warrants or controlled by legal standards. Given your current leadership on privacy and 4th Amendment issues, it is our hope that you will be thoughtful about authorizing programs to comb through private financial data without providing sufficient Constitutional and privacy safeguards.

Potentially Perverse Incentives for Whistleblowers

In Section 306, the draft ILLICIT CASH Act creates a monetary reward scheme for whistleblowers that report certain kinds of noncompliance to the authorities. Generally speaking, one concern of such financial awards is that they can encourage false accusations that can have substantial negative impacts on the lives of others. In addition, monetary awards can be directly tied to the amount of money recovered by the government as a result of the tip. Whistleblowers are thus not incentivized to report smaller violations and are instead incentivized to allow violations to accrue to increase monetary awards, which is also against good public policy.

Potential Violation of the Attorney-Client Privilege

Section 402 of the draft ILLICIT CASH Act requires any person involved in a real estate transaction to file a detailed report with the Treasury Department. Attorneys often represent clients in real estate transactions and therefore this provision could compel attorneys to disclose confidential client information to the government, which would contravene the attorney-client privilege and would cause attorneys to violate legal and ethical duties to their clients. We encourage you to thoughtfully ensure that any reporting requirements mandated by the federal government do not inadvertently undermine the sacrosanct attorney-client privilege.

Conclusion

In sum, the Due Process Institute supports reasonable and necessary measures to combat money laundering and terrorist financing. We welcome the opportunity to discuss workable options that do not undermine due process rights, privacy protections, the attorney-client privilege, and other sound public policies concerns. We hope you share our concerns and work to make meaningful improvements to the draft legislation before it is introduced.

Sincerely,

Shana-Tara O'Toole
President, Due Process Institute