November 28, 2017

The Honorable Stevan Pearce
Chairman
Subcommittee on Terrorism and
Illicit Finance
U.S. House of Representatives
Washington, DC 20515

The Honorable Ed Perlmutter
Ranking Member
Subcommittee on Terrorism and
Illicit Finance
U.S. House of Representatives
Washington, DC 20515

The Honorable Blaine Lutkemeyer
Chairman
Subcommittee on Financial Institutions and
Consumer Credit
U.S. House of Representatives
Washington, DC 20515

The Honorable Wm. Lacy Clay
Ranking Member
Subcommittee on Financial Institutions
Consumer Credit
U.S. House of Representatives
Washington, DC 20515

RE: Discussion draft of "Counter Terrorism and Illicit Finance Act"

Dear Chairmen and Ranking Members:

The National Association of Criminal Defense Lawyers (NACDL), American Civil Liberties Union (ACLU), and FreedomWorks write to oppose the discussion draft legislation entitled "The Counter Terrorism and Illicit Finance Act," which is scheduled to be considered at a joint hearing between the Terrorism and Illicit Finance Subcommittee and Financial Institutions and Consumer Credit Subcommittee titled "Legislative Proposals to Counter Terrorism and Illicit Finance" on November 29, 2017.

Section 4 of the proposed bill would dramatically expand Section 314(b) of the Patriot Act[1] to apply to a broad array of non-terrorism crimes, resulting in a dramatic increase in the sharing of Americans' sensitive financial information without a warrant or court approval of any kind. In doing so, it would likely cause law-abiding banking and other financial services customers to be improperly de-banked, preventing them from engaging in critical financial activities like home buying, investing, or even having a bank account. In addition, Section 9 of the bill would create new, unnecessary criminal penalties that could result in imprisonment of individuals who have no intent to violate the law, including small business owners who simply lack the resources to understand complicated new disclosure requirements. We urge members to oppose the discussion draft unless these provisions are removed or adequately amended.

[1] USA PATRIOT Act of 2001 (P.L. 107-56).

Section 4 would dramatically expand Section 314(b) of the Patriot Act to apply to over 100 domestic, non-terrorism crimes.

Section 4 would radically expand "information sharing" under Section 314(b) of the PATRIOT Act to apply to crimes beyond terrorism or money laundering, resulting in the erosion of privacy for nearly every consumer of a financial service. This provision would coerce a broad swath of "financial institutions" to spy on their customers, and ultimately report any information they discover related to over 100 additional domestic, non-terrorism, crimes to other financial institutions and ultimately to federal authorities because of other existing Bank Secrecy Act requirements. Not only would this effectively eliminate customer privacy on the basis of some employee's "suspicion," it would also likely cause many low-income consumers to be improperly excluded from legitimate financial markets, home-buying, and other legitimate needs.

We note at the outset that the existing language of Section 314(b) and its implementing regulations already give significant cause for concern and fail to adequately protect Americans' Fourth Amendment rights. Regulations implementing Section 314(b) are the mechanism by which the Financial Crimes Enforcement Network (FinCEN) currently "encourages" financial institutions to share information with one another regarding individuals and organizations that, for any reason or no reason, they merely "suspect" might be engaged in possible terrorist or money laundering activities. Disturbingly, this existing standard is low and these institutions would be encouraged to share this information with each other and the government, despite the fact that the government has never obtained a warrant or court order of any kind.

The "financial institutions" covered by Section 314(b) include traditional banks as well as less traditional institutions like check-cashing businesses, insurance companies, real estate firms, casinos or even car dealers.[2] Though on its surface Section 314(b) seems to only encourage information sharing between these businesses, at a practical level, Section 314(b) information-sharing is also a means by which FinCEN increases the number of Suspicious Activity Reports (SARs) it receives. When any financial institution receives information shared via 314(b), it triggers an internal investigation into the subject of the investigation, and almost always results in SARs being filed with the government. Indeed, because a financial institution can face criminal prosecution for failing to investigate or file SARs after receiving such information, these institutions invariably err on the side of overfiling.[3] These SARs in turn, provide essentially any piece of information known to the financial institution to the government, whether or not that information bears directly on the target of the inquiry. Already, over one million SARs are filed each year—with the vast majority never leading to a formal investigation of any kind, much less a terrorism related prosecution. Most people never learn that a transaction of theirs triggered scrutiny since financial institutions are subject to liability should they disclose the existence of the report to "any person involved in the transaction," which includes their own customer.[4]

[2] 31 C.F.R. §§ 1010.520(a)(1), 1010.540(a)(1).
[3] 31 C.F.R §§ 2020.520(d), 1010.540(d).
[4] 31 U.S.C. §§ 5318(g)(3)(A)(i),(ii).

Recognizing the enormous privacy invasion that Section 314(b) represents, Congress confined the current statutory law to make clear that *only* suspected terrorist or money laundering activities are subject to the program. Section 4 of the discussion draft would change this information-sharing program profoundly. Its goal is to broaden the impact of Section 314(b) information-sharing well beyond suspected terrorism and money laundering to also include *any* "specified unlawful activity (as defined under section 1956(c)(7) of title 18, United States Code)." This would encompass inquiries into financial and other personal and business records on the mere suspicion of a financial institution employee that a person or company engaged in *any* transaction that *might* have involved any one of the well over 100 federal crimes set out in Section 1956(c)(7). That would include suspected violations of anything from the sale or distribution of a controlled substance to assistance program benefits fraud to copyright infringement and importation laws.

This change would radically expand government surveillance on completely innocent participants in the economy. Financial institutions would be "encouraged" to spy on their own customers, and report information to each other about anyone who has ever engaged in a transaction with a person who in turn is merely "suspected" of having violated nearly any federal crime. And while Section 314(b) information-sharing does not explicitly reference information sharing with law enforcement, financial institutions *must* continue to file a SAR any time they learn about vaguely suspicious conduct involving any customer. In fact, it is a felony for a financial institution to fail to file SARs if they learn certain information.[5] With liability only for underfiling SARs,[6] financial institutions would actively investigate their own clients and would file even greater numbers of highly invasive SARs. The vast majority of customers who would be caught up in this surveillance would, in fact, be completely innocent of any wrongdoing. Thus, the proposed change would result in vast amounts of sensitive information being shared with the government under a low standard, without a warrant or court approval of any kind, and in the face of overwhelming evidence that the vast majority of individuals impacted have no connection to terrorism or any related crimes. This represents a disturbing invasion of Americans' privacy rights.

Moreover, as a result of this proposed law, financial institutions would simply and unfairly "debank" or otherwise stop doing business with those it deems as "low-value" customers. When a financial institution is faced with a massive influx of information about potentially suspicious activity, coupled with civil or even criminal liability if the institution fails to act on the information, many institutions will simply choose to stop doing business with current or potential customers they deem to be risky, particularly customers who carry low

[5] See 31 U.S.C. §§ 5318(g)(1) (requiring SARS filings), 5322 (felony penalties); United States v. HSBC Bank USA, N.A., 12-cr-763, 2013 WL 3306161, at *10 (E.D. N.Y. July 1, 2013) (approving deferred prosecution agreement for HSBC's failure to adequately investigate transactions and staff AML programs); United States v. Belair Payroll Services, Inc., et al., 11-cr-591, 2012 WL 9511587 (E.D. N.Y. June 12, 2012) (superseding indictment, alleging, among other things, failure to maintain appropriate anti-money laundering practices and inadequate SARs reporting).

[6] The draft language would also expand civil liability protection for financial institutions for customer privacy violations regardless of whether the financial institution failed to act "in good faith."

balances. Low income customers would therefore be excluded from crucial financial services.[7] This further exacerbates problems with money insecurity for the poor, and, ironically, diverts transactions into less transparent channels that bear greater risks of money laundering activities.[8]

Section 9 would create new, unnecessary criminal penalties that could even apply in cases where individuals intend to comply with the law and their conduct has resulted in no public harm.

Section 9 would impose a criminal penalty of up to three years of imprisonment for conduct that is, in essence, a paperwork violation—even for a first-time offender. Given the bill's broad reach and vague definitions, the provision could result in the conviction of individuals who have no intent to violate the law, whose greatest offense may simply be not understanding complicated and vague financial rules, and whose conduct results in no harm. Such a change is unnecessary, unwise, and fundamentally unjust.

The draft provision would require any "applicant" who wishes to form a corporation or limited liability company under the laws of any state to file and update with FinCEN information concerning anyone deemed a "beneficial owner" of the company. Unfortunately, the term "applicant" is undefined so it is unclear to whom the numerous specific obligations apply—whether it be the entity itself, a natural person affiliated with the entity, or a lawyer who has been hired to help form the new entity. The act then requires the "applicant" to provide a list of every "beneficial owner" of the business, along with various other information (such as current addresses of those owners), to FinCEN. The discussion draft also does not provide clarity in the definition of who qualifies as a "beneficial owner."

The vague definitions for "applicant" and "beneficial owner" are particularly concerning given that the bill criminalizes various activities related to failing to comply with the new requirements referenced above. For example, the draft bill criminalizes the failure to provide complete or merely current beneficial ownership information as well as the provision of incorrect beneficial ownership information, but the definition of who constitutes a "beneficial owner" is both overly broad and vague. As a result, someone could be prosecuted for simply failing to understand what the law actually requires.

Under the current language, any person who "directly or indirectly" through any "contract, arrangement, understanding, relationship, or otherwise," has "substantial control over," "owns 25 percent or more of the equity interests," or "receives substantial economic benefits from" the corporate entity, is a beneficial owner. (Further, a "substantial economic interest" is circularly defined as "entitlement to the funds or assets of the company" that "as a practical matter, enables the person, directly or indirectly, to control, manage, or direct the corporation.") To illustrate the vagueness of this definition—how would an applicant be able to always properly identify anyone with an informal "understanding" to "indirectly" be entitled to assets of a company sufficient to control the company, "as a practical matter?" And the inclusion

[7] Matthew Colin et al., Unintended Consequences of Anti-Money Laundering Policies for Poor Countries, Center for Global Development, 2015, https://www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf.
[8] Id.

of a catch-all phrase such as "or otherwise" renders any previous definitional clauses inconsequential. Unlike other existing definitions of "beneficial owner," the draft bill's definition does *not* require that an individual have any agreement bestowing control or entitlement to funds, nor does the draft bill require someone to *actually* control, manage, or direct the corporation. Instead, the definitions that serve as the basis of these new legal obligations are frustratingly vague. Fundamental notions of fairness, as well as basic constitutional principles, require that individuals understand what is required of them under the law before they can be imprisoned for noncompliance.

The concerns that arise over vague definitions for key statutory terms are compounded by the specific application of some of the criminal provisions. For example, the disclosure offense at (c)(1)(A)(iii), which makes it a crime to disclose "the existence of a subpoena, summons, or other request for beneficial ownership information," is extremely troubling because it is not limited in its application to people who would be on notice of the prohibition of such a disclosure. There is nothing inherent in this type of situation that would naturally alert anyone that any request for information should not be disclosed. To criminalize the disclosure of a request for such commonplace information (like the name and address of a business's owner) could thus turn law-abiding individuals into felons. Similarly, the offense at (c)(1)(A)(i) punishes the act of knowingly providing not only fraudulent information but also "false" beneficial ownership information. Given the broad reach of the definition of the term "beneficial ownership," a person might well provide "false" information based only on a misunderstanding of the law's terms. In many cases, federal courts have wrongly interpreted similar language to require that individuals only deliberately and consciously performed the act, not that they were aware that such activity was a violation of law. Thus, a person might face criminal punishment for knowingly providing information, which happens to have been incorrect, even if that person fully intended to comply with the law.

These new disclosure obligations will disproportionately impact small businesses that may be least equipped to understand the complicated set of new requirements. The draft bill provides a lengthy list of large sophisticated exempt business entities, thus leaving the disclosure obligations to fall predominantly on small businesses. These small businesses are less likely to have sophisticated in-house lawyers or the resources to engage outside attorneys for the purpose of properly understanding and meeting these new disclosure requirements. Thus, many small business owners will be forced to decide between the risk of possible criminal prosecution and the expense of counsel; though, for many, financial circumstances will dictate the decision. Surprisingly, this legislation would apply retroactively and apply to all existing legal entities (not just those formed after enactment). Thus, with no notice, small businesses that have been in operation for decades will suddenly be subject to brand new obligations, which, if they do not meet, can trigger criminal penalties including jail time.

The inclusion of new federal criminal penalties for first-time "paperwork" violations into felony criminal offenses is a dramatic step in the wrong direction. Criminal prosecution and punishment constitute the greatest power that a government routinely uses against its own citizens. This law would result in a criminal conviction and up to 3 years' imprisonment for a person's failure to provide the proper paperwork. This could include a person who is merely sloppy or lazy, or who happens to make a mistake, even where there is no actual harm resulting

from his or her conduct. None of these offenses require a specific intent to assist others in violating the law, or require the showing of any harm to another individual or the United States. This is, quite simply, a punishment that does not fit the crime, which will further contribute to over criminalization.

No matter how well-intentioned, Sections 4 and 9 of the proposed Counter Terrorism and Illicit Finance Act would have a disastrous impact on those bearing no relation to terrorism or money laundering Instead it would virtually eliminate customer privacy for anyone who uses a wide array of financial services, lead to an exponential increase in the number of SARs filed, and would create new, unnecessary federal criminal laws based on vague and overreaching definitions. Another concerning aspect of both Sections 4 and 9 is that each section authorizes the Treasury Department to promulgate additional civil and criminal regulations to enforce them. This is concerning given that the regulatory state is already out of control. Congress should not continue to surrender even more of its lawmaking authority to unelected bureaucrats. For all the reasons listed herein, we urge you to oppose the bill unless these provisions are removed or appropriately amended.

If you have further questions, feel free to contact Shana O'Toole (202-465-7627 or sotoole@nacdl.org), Neema Singh Guliani (202-675-2322 or nguliani@aclu.org), or Jason Pye (202-942-7634 or jpye@freedomworks.org).

Respectfully,

The American Civil Liberties Union (ACLU)
FreedomWorks
The National Association of Criminal Defense Lawyers (NACDL)