The Heritage Foundation
Executive Memorandum

No. 693

August 31, 2000

THE COUNTER-MONEY LAUNDERING ACT: AN ATTACK ON PRIVACY AND CIVIL LIBERTIES

SCOTT C. RAYDER

Congress has renewed its efforts to combat international money laundering in recent months. In the House of Representatives, Representative Jim Leach (R–IA) has introduced H.R. 3886, the International Counter-Money Laundering Act, which has moved swiftly through the Banking Committee and is now positioned to move to the House floor. In the Senate, John Kerry (D–MA) has introduced an identical bill, S. 2972.

The stated goal of both bills is to track down the funds that criminals keep in financial institutions worldwide. Their real impact, however, would be to restrict constitutional freedoms by undermining the Fourth Amendment right to be free from government criminal investigations without reasonable and specific evidence of wrongdoing. They are also likely to impinge on consumers' financial privacy. Moreover, their effect would be less to corral drug kingpins than to make it easier for large nations to collect taxes by forcing smaller nations to violate their citizens' financial privacy.

Compromising Financial Privacy. The legislation states that "certain kinds of transactions involving offshore jurisdictions...make it difficult for law enforcement officials and regulators to follow the trail of money earned by criminals and organized criminal enterprises." It may be difficult to follow these dealings, but it is certainly not impossible; nevertheless, the bills would give federal law enforcement agencies greater powers to scrutinize financial transactions in foreign jurisdictions.

They would also force U.S. financial institutions to profile consumers for unusual activity, identify situations in which money laundering may be taking place, and reveal "suspicious" activity to federal law enforcement agencies. These provisions are similar to the "Know Your Customer" rule proposed in 1998, which would have forced domestic financial institutions to reveal individual account information to law enforcement agencies. The rule was hotly contested and ultimately was withdrawn in the spring of 1999. These provisions of H.R. 3886/S. 2972 are simply an international "Know Your Customer" rule.

Produced by the
Thomas A. Roe Institute
for Economic Policy Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em693.html*

The legislation would waive liability in money-laundering cases for any financial institution that agreed to disclose information and to work with federal law enforcement and regulatory authorities. In other words, American financial institutions would have to violate their customers' financial privacy or assume liability for their patrons' potentially illegal business. In effect, these bills would force banks to spy on their customers. Furthermore, banks would employ computer software to make

customer "profiles," and then could share this information with affiliates or sell it to third parties in order to recover the cost of data collection.

Fighting Crime or Low Taxes? H.R. 3886/S. 2972 would give the Secretary of the Treasury broad new powers to require U.S. financial institutions to reveal data about their customers. If the Secretary found that there were "reasonable grounds" for believing that an American financial institution's patrons were laundering money in a foreign jurisdiction, he could require that institution to reveal customer information. The Secretary would be able to consider whether the alleged money laundering was taking place in a country "characterized as a tax haven," and could then target low-tax regimes regardless of whether they tolerated money laundering.

The Secretary also could prohibit certain consumer financial transactions, transactions with certain financial institutions, and transactions with countries deemed by the Secretary to be in noncompliance. Thus, due process of law would be subject to the discretionary whims of the Secretary of the Treasury, who would be able to force American financial institutions to comply with U.S. law enforcement activities and tax objectives abroad.

This provision raises serious search and seizure concerns. In a normal criminal investigation, the federal government must have probable cause to believe that a person has committed a crime in order to search personal records. By lowering the bar for probable cause, H.R. 3886/S. 2972 would enhance the potential for governmental abuse since the government needs only "reasonable grounds" to believe that some person at a foreign or domestic bank is doing business in a foreign country that might harbor money launderers. The government can then require the bank to provide access to *every* depositor's account information in any country.

Taken a step further, the "reasonable grounds" clause could justify wide-ranging federal investigations of private companies and individuals. Under this legislation, for example, since some criminals like expensive cars, federal law enforcement agencies conceivably could require all car dealerships that sell American or foreign-made automobiles to open their books to determine whether any illegal activity was occurring.

A Taxing Alliance? H.R. 3886/S. 2972's international provisions would mandate U.S support for the Organisation for Economic Co-operation and Development's Financial Action Task Force (FATF) on Money Laundering. The OECD is a group of unelected bureaucrats from 29 wealthy countries, including the United States, devoted to economic and social policy. The FATF, ostensibly devoted to combating money laundering, is actually a means through which member nations with high tax burdens (such as France) can pursue taxpayers and businesses that protect their assets overseas in so-called tax havens.

H.R. 3886/S. 2972 would compel the United States to "actively and publicly support the objectives of the FATF." They would urge the United States to sanction tax-friendly nations if they do not cooperate with the OECD, thereby compromising their sovereignty. The OECD has called for the elimination of "preferential tax regimes," and this legislation would bind the United States to the OECD's collective will. It would also severely curtail financial privacy by forcing U.S. financial institutions to play an instrumental role in identifying "preferential tax regimes."

The justification for these assaults on financial privacy and national sovereignty is that the legislation presumably will prevent money laundering. In reality, however, these provisions of H.R. 3886/S. 2972 would achieve one of the OECD's long-standing goals by driving assets out of tax-friendly nations so that the world's high-tax nations can prop up their welfare states.

—Scott C. Rayder is Senior Technology Policy Analyst in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.