Comments to the Financial Crimes Enforcement Network on “Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern”

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To whom it may concern:

Coin Center is an independent nonprofit research and advocacy center focused on the public policy issues facing cryptocurrency technologies such as Bitcoin. Our mission is to build a better understanding of these technologies and to promote a regulatory climate that preserves the freedom to innovate using open blockchain technologies. We do this by producing and publishing policy research from respected academics and experts, educating policymakers and the media about blockchain technology, and by engaging in advocacy for sound public policy.

We welcome this opportunity to comment on the Financial Crimes Enforcement Network’s (“FinCEN”’s) rulemaking to designate convertible virtual currency (“CVC”) mixing as a primary money laundering concern (“PMLC”). Several facets of this rulemaking are unprecedented, exceedingly broad, and ultimately contravene the agency’s underlying statutory authority and our Constitution. We will discuss these issues and offer suggestions and processes that might limit the dangerous and unintended consequences of this rule throughout.

Unprecedented and Exceedingly Broad

The USA PATRIOT Act empowered FinCEN to designate four very different things as primary money laundering concerns: (1) jurisdictions, (2) financial institutions, (3) classes of transactions, and (4) types of accounts. This rulemaking is unprecedented because in the 23 years since the 311 power was created by Congress it has never once been used by FinCEN to identify an entire class of transactions as a PMLC.[1] Given the novelty of this type of

[1] According to its website, FinCEN has engaged in 28 PMLC designation rulemakings with 22 of those rulemakings designating banks or other financial institutions (*e.g.* Asia Wealth Bank and custodial CVC

designation, there is no existing body of law to aid reporting entities in determining how the scope and limits of any given class of transactions should be understood. There is also no body of law to inform innocent Americans of their rights and opportunities for a hearing should their transactions be wrongly subjected to a PMLC designation and should they suffer the serious collateral economic and reputational consequences that inevitably attend such a designation. Therefore, this rule must be especially clear and narrowly tailored to avoid unintended consequences. As we discuss below, as drafted it is not.

The particular definition chosen in order to designate a class of cryptocurrency transactions as a PMLC is notably broad, even by FinCEN's own account in this rulemaking.[2] That breadth would baselessly tar many legitimate transactions as criminal. The other types of designations available under Section 311 are self-limiting: a jurisdiction is a jurisdiction, an institution is an institution, a class of transactions, however, is a metaphysical category with uncertain bounds. It is easy to say that one went to Italy (a jurisdiction) or visited the Uffizi (an institution), but it's more difficult to say whether one traveled by car or plane (one probably did both) and even more difficult to say whether one traveled there *with gusto* (a subjectively definable, if only loosely, class of actions one can take).

The proposed definition of CVC mixing includes six different broad but objectively definable *ways* of transacting using CVC,[3] many of which are mere common practice amongst persons who know how to use cryptocurrency and wish to do so carefully. Even these broadly defined transaction types are not the actual limit to the definition; any transaction made "in a manner

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mixing service Bitzlato, which is a Money Service Business), 5 designating jurisdictions (e.g. Democratic People's Republic of Korea and the Islamic Republic of Iran), and 1 rulemaking—this rulemaking—designating a class of transactions, CVC mixing. *See* Department of the Treasury, Financial Crimes Enforcement Network, "311 and 9714 Special Measures, Special Measures for Jurisdictions, Financial Institutions, or International Transactions of Primary Money Laundering Concern" https://www.fincen.gov/resources/statutes-and-regulations/311-and-9714-special-measures

[2] *See* Department of the Treasury, Financial Crimes Enforcement Network, "Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern," 88 F.R. 72701, pgs. 72701-72723, on pg. 72709, https://www.govinfo.gov/content/pkg/FR-2023-10-23/pdf/2023-23449.pdf ("FinCEN acknowledges this definition is relatively broad; however, given the nature of CVC mixing, FinCEN deems the breadth of this definition to be necessary.").

[3] *Id.*, at 72709 ("(A) Pooling or aggregating CVC from multiple persons, wallets, addresses, or accounts; (B) Using programmatic or algorithmic code to coordinate, manage, or manipulate the structure of a transaction; (C) Splitting CVC for transmittal and transmitting the CVC through a series of independent transactions; (D) Creating and using single-use wallets, addresses, or accounts, and sending CVC through such wallets, addresses, or accounts through a series of independent transactions; (E) Exchanging between types of CVC or other digital assets; or (F) Facilitating user-initiated delays in transactional activity.").

that obfuscates the source, destination, or amount involved" is deemed a PMLC under the proposed rule. If that standard applied to non-CVC transactions, any transaction involving physical cash would be a PMLC. This category is wooly, subjective, and immense. It effectively includes any transaction made with privacy. This is, therefore, not a rule that is triggered by a reasonably definable event, such as actually traveling to Germany or actually entering the Bayreuth Festspielhaus and attending a particular performance of the Ring Cycle. Rather this is a rule that is triggered vaguely and often, such as whenever one listens to any music that is sufficiently "Wagnerian."

While this rulemaking makes some effort to quantify adverse effects on "the international payment, clearance, and settlement system," it fails to offer any account of its likely effects on individual cryptocurrency users who happen to be making legitimate CVC mixing transactions in order to protect their own privacy.[4] We imagine these effects will be profound given that a PMLC designation carries real economic consequences for the persons whose transactions are designated, such as financial account limits, blocks, and closures, as well as the moral condemnation and reputational harm that is likely to stem from being labeled a presumptive money launderer and criminal.

The brief section dealing with potential adverse effects claims that there will be "minimal" adverse effects "on legitimate business activities involving CVC transactions," however, the only reasoning offered to support this conclusion is the claim that "volatility and disruptions in the CVC ecosystem have been contained within the CVC markets and have not significantly spilled over to financial markets and infrastructures."[5] This suggests that FinCEN does not perceive a disruption to the CVC ecosystem as significant unless that disruption spills over into larger traditional financial markets. Respectfully, an American who is making legitimate CVC mixing transactions in order to protect her own privacy is equally as entitled to fair treatment and the benefits of the rule of law as is a multinational corporation transacting in the larger more traditional financial sector. Legitimate business activities involving CVC transactions will often have no impact on the larger market, but that does not mean that the rights and economic well-being of those making said transactions are of no consequence. Coin Center is concerned with the potential adverse effects of this rulemaking on these kinds of legitimate

[4] *Id.*, at 72708 ("FinCEN assesses that imposition of the proposed special measure would have minimal impact upon the international payment, clearance, and settlement system, or on legitimate business activities involving CVC transactions. As noted in the February 16, 2022, Financial Stability Board's Assessment of Risks to Financial Stability, direct connections between CVC and systemically important financial institutions and core financial markets are limited at present.] Volatility and disruptions in the CVC ecosystem have been contained within the CVC markets and have not significantly spilled over to financial markets and infrastructures.").

[5] *Id.*

transactions, and we would like to better understand the reasoning and underlying factual basis upon which FinCEN is relying in assuming that these effects will be minimal.

Additionally, FinCEN concedes that it has failed to determine "the extent to which, or quantity thereof, CVC mixing activity is attributed to legitimate business purposes."[6] Given the sparsity of this discussion in the present NPRM, there is no opportunity for meaningful public comment on the potential of such unintended consequences or the steps the agency has taken or intends to take in order to minimize these harms.

Beyond the Statutory Authority

Most relevant to the statutory and constitutional limits binding on FinCEN, this rulemaking makes no effort to define a class of transactions such that it is appropriately limited to transactions within or involving a foreign jurisdiction. FinCEN concedes that reporting entities have no actual ability to determine the jurisdiction of a given CVC mixing transaction.[7] FinCEN identifies this problem as the reason for not further limiting the category of PMLC transactions to only those involving North Korea or "any similarly narrow approach, regardless of the actors involved."[8] In spite of this admitted inability to discriminate, FinCEN specifies that reporting is only required when a reporting entity "knows, suspects, or has reason to suspect" that the transaction is foreign rather than domestic. If there is no actual way to know the jurisdiction of the transaction, one wonders upon which facts or clues a reporting entity will base this suspicion? The rulemaking is silent on that question.

Presumably, after noting that a transaction is CVC mixing (again, an extremely broad and subjective category), a reporting entity will need to decide whether that fact alone makes it a reportable transaction or whether the fact that it cannot be shown to be foreign makes it a non-reportable transaction. Coin Center assumes that without a public rule offering guidance

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[6] *Id.*, at 72707 ("FinCEN is concerned that CVC mixing makes CVC flows untraceable by law enforcement and makes potentially suspicious transactions unreportable by responsible financial institutions—thereby fostering illicit activity as described elsewhere in this document. More importantly, FinCEN assesses that the percentage of CVC mixing activity attributed to illicit activity is increasing. At the same time, because of the lack of available transactional information, FinCEN cannot fully assess the extent to which, or quantity thereof, CVC mixing activity is attributed to legitimate business purposes.").

[7] *Id.*, at 72709 ("Given the nature and use of CVC mixing, covered financial institutions would typically have insufficient information to determine whether the CVC transaction was initiated *[sic]* North Korean-affiliated actors. FinCEN believes this would be true of any similarly narrow approach, regardless of the actors involved. Therefore, FinCEN has determined that additional recordkeeping and reporting requirements set forth in this proposed rule would best mitigate the risks associated with CVC mixing, deter illicit actors, facilitate law enforcement investigations into illicit activity, and adequately protect the U.S. financial system from the illicit financial risk posed by CVC transactions that involve CVC mixing, while preserving legitimate actors' ability to conduct secure and private financial transactions.").

[8] *Id.*

on that topic, most risk averse reporting entities will simply report *all* CVC mixing transactions including those that are in fact purely domestic in nature. After all, the reporting entity may suppose, these are *potentially* foreign given that by their nature we cannot know for sure where in the world they took place. Therefore, all CVC mixing transactions are transactions that the entity may suspect to be foreign. By remaining silent on what the basis of this suspicion should and should not be and by suggesting that determining the actual location is anyways impossible, the rulemaking tacitly advises that all CVC mixing transactions including purely domestic transactions are reportable and should be reported under the rule.

FinCEN admits in this NPRM that "other forms of CVC mixing, that do not involve the use of CVC mixers, *do occur within the United States*"[9] [emphases added] and yet has made no effort in this NPRM to explain how such purely domestic activities would be excluded from PMLC designations.

Taken together, these several facets of the proposed designation would subject a vast swath of legitimate and purely domestic transactions between law-abiding Americans to a designation that will bring severe moral condemnation and collateral economic consequences to those transacting. If an American regularly made legitimate and purely domestic CVC mixing transactions, merely to protect her own privacy while using cryptocurrencies (e.g. because she gets paid her salary in crypto or wishes to engage privately in protected First Amendment activities like charitable donations) her transactions would nonetheless be classified as a PMLC and it is probable that her cryptocurrency accounts at financial institutions will be closed or rate limited due to heightened compliance costs and the risk-averse nature of regulated financial institutions. All of this will happen even though she has not engaged in any criminal activity and is not even suspected of committing any actual crimes.

Unmodified, this rulemaking exceeds the statutory power delegated to FinCEN under the PATRIOT Act. The Act does not allow for the designation of *any* class of transactions as a PMLC; it only allows FinCEN to designate a class of transactions "*within or involving a foreign jurisdiction*."[10] The proposed rule leaves it to the discretion of the reporting entity as to whether

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[9] *Id.*, at 72704 ("The global nature of the problem is further demonstrated by the fact that no CVC mixers are currently registered with FinCEN. CVC mixers are required to register with FinCEN if they do business as money transmitters wholly or in substantial part within the United States. To the extent foreign CVC mixers are operating beyond United States jurisdiction, they are not subject to U.S. regulations that require financial institutions to, among other things, know the identity of their customers and report suspicious activity to FinCEN. Nevertheless, FinCEN assesses that other forms of CVC mixing, that do not involve the use of CVC mixers, do occur within the United States.").

[10] 31 U.S. §5318A(a)(1) ("The Secretary of the Treasury may require domestic financial institutions and domestic financial agencies to take 1 or more of the special measures described in subsection (b) if the Secretary finds that reasonable grounds exist for concluding that … 1 or more classes of transactions ***within, or involving, a jurisdiction outside of the United States*** … is of primary money laundering

they "suspect" a transaction is foreign, and the rule makes no effort to define any criteria or indicia of foreignness upon which a reporting entity could rely or at least use as the basis of its compliance decisions. Indeed, FinCEN admits that determining the jurisdiction of a CVC mixing transaction is impossible. Accordingly, the rule will trigger reporting of purely domestic transactions in direct contravention of an unambiguous statutory limitation.

FinCEN may argue that by choosing a milder recordkeeping and reporting special measure rather than a stronger blocking special measure under its 311 authority,[11] it is avoiding the issues of overapplication and extralegality discussed herein. This is not the case. While the PATRIOT Act does require FinCEN to weigh all of the alternative special measures in each rulemaking, the law does *not* give FinCEN the authority to use *any* of the special measures on transactions that are purely domestic. All of the alternative measures reviewed by FinCEN in this rulemaking apply exclusively to transactions with or involving a foreign jurisdiction and therefore cannot encompass purely domestic transactions.

To preserve the validity of this rulemaking, FinCEN should at least attempt to offer a definition of when a CVC mixing transaction should be deemed by the reporting entity to be "within or involving foreign jurisdictions" in order to ensure that *only* those transactions actually within or involving foreign jurisdictions are included in the reporting scheme. If this is impossible, then it is up to Congress to speak on the *major question* of whether the impossibility of limiting reporting obligations to foreign transactions should necessitate new statutory language that authorizes the designation of purely domestic transactions as a PMLC. Congress has never spoken on that question and no statutory authority exists that allows FinCEN to do so.

Respectfully, Coin Center wishes to learn from this comment period specifically how FinCEN intends for reporting entities to make the distinction between purely domestic and foreign transactions within the text of the rule. We wish to know if FinCEN genuinely believes it is impossible to make these determinations as suggested in the present NPRM.[12] Moreover, if some reasonable criteria can be determined, there should be an opportunity to offer advice and comment.

Therefore, we urge FinCEN to engage in at least one further NPRM before any final rule is issued. That NPRM should discuss how reporting entities can make foreign versus domestic determinations and whether it is feasible to exclude purely domestic CVC transactions from

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concern… .") The statutory authority clearly limits the category of "class of transactions" to a class that occurs within or involves a jurisdiction outside of the United States. Defining the class to include purely domestic transactions that involve no jurisdiction outside of the United States runs directly contrary to the express will of Congress as found in the statute.

[11] *Id.*, at 72709 (for the assessment of which special measures are appropriate to impose).

[12] *Supra* note 6.

reporting obligations. Such a further NPRM should disclose all non-public unclassified materials upon which its conclusions are based. Without such a subsequent NPRM, how will potentially affected Americans become fully aware of the many ways that they may be inappropriately swept into a PMLC report? Only by engaging in a further NPRM before a final rule will the American public be able to offer comments on what will be, for them, the most consequential aspect of the rule as drafted. To fail to allow for public comment on such a consequential aspect of this rule would clearly show an arbitrary and capricious disregard for the strictures of the PATRIOT Act, the strictures of the Administrative Procedure Act, as well as extreme indifference to the legitimate liberty and property interests of all those Americans who would be unfairly, extralegally, and unconstitutionally swept into a PMLC designation merely because they made a legitimate domestic CVC mixing transaction.

An Unconstitutional Deprivation without Due Process

The breadth of the proposed designation, as well as its application to purely domestic transactions, is not just a matter of insufficient statutory authority. Even if one was to wrongly parse the PATRIOT Act to allow the PMLC designation of purely domestic transactions, doing so would contravene the constitutional rights of Americans who are subject to reports.

Under the Fifth and Fourteenth Amendments, the state may not deprive citizens of life, liberty, or property without notice and an opportunity for a hearing before a neutral magistrate. In determining whether a deprivation of property or liberty has occurred, the Supreme Court employs the test established in *Mathews v. Eldridge*.[13] This test involves three factors: (1) the private interest affected by the government action, (2) the risk of an erroneous deprivation through the procedures used and the probable value of additional or substitute procedures, and (3) the government's interest, including the function involved and the fiscal and administrative burdens additional or substitute procedural requirements would entail.[14]

Applying this test to an American's designation as a PMLC, such a designation could satisfy the test for deprivation of property or liberty. The private interest involved is significant, as a PMLC designation can lead to severe economic and reputational harm. The risk of erroneous deprivation is substantial, especially in this case where the class of transactions to be designated is exceedingly broad and will include, by FinCEN's own admission, legitimate domestic transactions. The government's interest in preventing money laundering is strong, but it must be balanced against the need for fair procedures to protect individuals or entities from unjustified or mistaken deprivations.

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[13] *Mathews v. Eldridge*, 424 U.S. 319 (1976).
[14] *Id.*, at 334-335.

A PMLC designation process for an entire class of transaction does not involve providing *any* specific notice to the actual affected parties or *any* opportunity for an evidentiary hearing as to the specific facts of the specific parties whose transactions end up being designated. In this case, there is no process for notifying and hearing from potentially designated parties whatsoever aside from this highly generalized rulemaking that will have concluded long before many Americans have their transactions designated, and their financial accounts flagged, or even closed as a result.

Many Americans have no idea that their otherwise legitimate transactions may, if this rulemaking is finalized, be on the wrong end of a PMLC designation and therefore they will have no idea that this rulemaking's public comment period is their only opportunity to be heard. Many will only learn about such a designation after their accounts at major financial institutions have been flagged and closed. Indeed, many may not even learn about this designation process at all and will only be told that the reason their account was flagged and closed was some vaguely articulated concern over money laundering risk, if any reason is offered at all.

Furthermore, notice and comment rulemaking is not a constitutionally appropriate substitute process for an actual adversarial hearing before a neutral magistrate when the risks of erroneous deprivations are high. There is a dearth of case law on due process issues surrounding PMLC designations and that is not because the rights of Americans are adequately protected by the notice and comment process, but rather because Americans have rarely if ever been the target of such designations. In past cases, the targets have been overseas entities with few domestic contacts.[15] Courts often forgo any due process analysis because the foreign plaintiff is not entitled to American due process protections.[16]

Moreover, in all past cases the designation has been specific to a finite foreign geographical region or a particular financial institution rather than, as here, a broad and vaguely-defined category of activities in which many ordinary Americans engage. In the past, the number of potential plaintiffs to whom due process is entitled has been vanishingly small. That will not be the case with this designation. Should there be no steps taken to limit this designation to

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[15] *See, e.g.*: "Special Measures for Jurisdictions, Financial Institutions, or International Transactions of Primary Money Laundering Concern," Department of the Treasury, Financial Crimes Enforcement Network, accessed January 16, 2024, https://www.fincen.gov/resources/statutes-and-regulations/311-and-9714-special-measures.

[16] See e.g. *FBME Bank Ltd. v. Lew*, 125 F. Supp. 3d 109, 118 (D.D.C. 2015) ("The Court does not decide, however, whether FBME is likely to succeed on the merits of its due process claim, Count III, because the record is currently unclear as to whether FBME has sufficient presence or property in the United States to establish an entitlement to due process at all. And because the Court has determined that FBME is likely to succeed on certain aspects of its APA claims, the principle of constitutional avoidance counsels against examining the merits of FBME's constitutional claim.")

genuinely foreign transactions representing real money laundering risks rather than mere legitimate business activities, there will be abundant opportunities to expand the case law on the due process rights of persons wrongly designated as a PMLC. Coin Center hopes it does not come to that but stands ready to help challenge such an unjust application of the PATRIOT Act to ordinary Americans engaged in legitimate efforts to protect their privacy.