

Cryptocurrency, Money Service Businesses and Anti-Money Laundering Laws

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Money laundering is the process of making illegally-gained ("dirty") money appear legal ("clean"). The United States' anti-money laundering ("AML") laws and regulations, including its "Know Your Customer" ("KYC") mandates, affect financial institutions far beyond US borders. The Trump Administration has indicated that AML enforcement remains a top priority and it has been quick to apply the existing regulatory regime to transactions involving cryptocurrency, given its frequent use for ransomware payments and sales of illicit and stolen goods.

Many legitimate business enterprises are now leveraging the potential of cryptocurrencies and blockchain technology. Merchant websites accept payments in virtual currency. At a variety of auction websites, buyers use cryptocurrency to purchase goods or services from sellers. Cryptocurrency exchanges allow people to purchase, sell and exchange cryptocurrencies themselves.

What are "Money Service Businesses" subject to AML/KYC Regulation?

Money Transmitters. Most commonly, MSB status results from a business being deemed under FinCEN regulations as a "money transmitter." A money transmitter is "[a] person that provides money transmission services" or "any other person engaged in the transfer of funds."¹ Money transmission services involve "the *acceptance* of currency, funds, or other value that substitutes for currency from one person and the *transmission* . . . to another location or person by any means."²

Types of Money Transmitters. To help define money transmitters of "virtual currency,"³ FinCEN has categorized them as "users," "exchangers," and "administrators." A *user* is "obtains virtual currency to purchase goods or services." An *exchanger* is a business engaged in the exchange of virtual currency for real currency, funds, or other virtual currency. Finally, an *administrator* is a business that issues (putting into circulation) and redeems (withdrawing from circulation) such virtual currency.

Users. Mere users of virtual currency are not money transmitters; consequently, they are not required to register as a MSB. ⁴



Exchangers. A business is a "money exchanger" (and thus a "money transmitter" and MSB) if any portion of its operation (1) exchanges virtual currencies for fiat currencies (e.g., US Dollars, Euros, etc.) or their equivalent (e.g., prepaid credit/debit cards), (2) exchanges one virtual currency for another virtual currency, (3) issues virtual currency, or (4) involves other similar transactions.

Administrators. In general, a business is an "administrator" if it issues virtual currency for use by others, then reserves the right or power to redeem or withdraw that virtual currency. Based upon this definition, the Treasury Department on FinCEN's behalf has opined that an issuer for value of coins or tokens in an Initial Coin Offering ("ICO") must comply with AML requirements.⁵

Territorial Scope. In a 2011 regulatory rule, FinCEN provided that foreign entities are subject to MSB regulation if they engage in money transmission within the United States. FinCEN noted that qualification as an MSB is based on the entity's activity within the United States, not the physical presence of any of its agents or offices in the United States.⁶ In other words, transactions with United States citizens, residents or businesses by an entity that is physically located outside the United States will be subject to MSB regulations, while these regulations do not apply if the transaction occurs entirely outside the United States.

What Does AML Compliance Entail?

As a MSB, a business is subject to various AML obligations, including: (1) registration with the United States Secretary of Treasury; (2) establishing AML programs; (3) filing currency transaction reports and suspicious activity reports; and (4) collecting and maintaining customer information and transaction records.⁷

Registration. First, to fulfill the registration requirement for a MSB, the entity must file FinCEN Form 107 within 180 days after the date the MSB is established (or US transactions are first handled). Thereafter, the MSB must proceed to renew registration every 24 months by December 31. Additionally, re-registration is required if the MSB changes ownership or control.⁸ Registration must include information regarding: (1) the name and location of the business; (2) the name and address of each owner, director or officer of the business; (3) the name and address of any depository institution at which the business maintains a transaction account; (4) an estimate of the volume of business in the coming year (which shall be reported annually to the Secretary); and (5) any other information the Secretary of Treasury may require.⁹ Further, a MSB must maintain a list of the names and addresses of all persons authorized to act as an agent for the business and make it available on request to any appropriate law enforcement agency.¹⁰ Finally, a foreign-located MSB must designate the name and address of an agent to accept service of process regarding its compliance with these regulations.¹¹

AML Compliance Program. Second, the MSB must develop and implement an AML compliance program. The goal of such program is to prevent individuals from using the MSB to facilitate money laundering or



finance terrorist activities. The program must be in writing, take into account the inherent risks and (1) designate a person to assure day-to-day compliance with the BSA; (2) incorporate policies, procedures and internal controls reasonably designed to assure compliance with the BSA; (3) provide education and training to appropriate personnel; and (4) provide for an independent review to monitor and maintain an adequate program.¹²

Reporting. Third, the MSB must report cash transactions and suspicious activities. If the MSB has a cash-in or cash-out (cash received or cash dispersed) currency transaction, or multiple transactions, totaling more than \$10,000 during one business day for any one person, or on behalf of any one person, it must file a Currency Transaction Report using FinCEN Form 112. Also, if the MSB has reason to suspect a suspicious transaction that involves \$2,000 or more, they must file a Suspicious Activity Report using FinCEN Form 111.¹³

Recordkeeping. Fourth, an MSB must maintain certain customer and transaction records outlined in the Code of Federal Regulations.¹⁴ Any records required must be retained for five years.¹⁵

What are the Consequences for Non-Compliance?

Violations can result in serious consequences. Failure of a money transmitter to register as an MSB under the BSA could result in up to 5 years imprisonment of any individual who knowingly conducts, controls, manages, supervises, directs or owns all or part of such unlicensed MSB. Additionally, a civil penalty of up to \$5,000 can be imposed (on the MSB or such individual) for each violation. Failure to comply with the registration requirement includes the filing of false or materially incomplete information. Each day a violation continues constitutes a separate violation.¹⁶

All virtual currency businesses need to determine if they are money transmitters or have otherwise triggered AML MSB obligations, which include FinCEN registration and implementation of an AML compliance program. Although the government's focus is on illegal and illicit money-laundering activities, it has nonetheless indicated that AML compliance is expected of any business that qualifies as a money transmitter, even if it has not engaged in money laundering of any kind.

Let the members of the Blockchain and Disruptive Technologies practice group at Lathrop Gage, led by Dale Werts and Tedrick Housh, answer your questions regarding the legal aspects of new technologies, like Blockchain and Bitcoin.

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About Our Practice

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[1] 31 CFR 1010.100(ff)(5)(i)(A)-(B).

[2] *Id.* ("Any means" includes, but is not limited to, through a financial agency or institution; a Federal Reserve Bank or other facility of one or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both; an electronic funds transfer network; or an informal value transfer system.")

[3] A "virtual" currency "is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. "Real" currency is "the coin and paper money of the "United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance." FIN-2013-G001.

[4] FIN-2013-G001.

[5] Treasury Assistant Secretary for Legislative Affairs letter to Sen. Ron Wyden, dated Feb. 13, 2018.

[6] Financial Crimes Enforcement Network, *FinCEN Clarifies Money Services Businesses Definitions Rule Includes Foreign-Located MSBs Doing Business in U.S.* (July 18, 2011).

[7] 18 No. 3 Cyberspace Law. 12.

[8] 31 CFR 1022.380(b); 31 U.S.C. § 5330(a).

[9] 31 U.S.C. § 5330(b).

[10] 31 U.S.C. § 5330(c).

[11] 31 CFR 1022.380(a)(2).

[12] 31 CFR §1022.210; Financial Crimes Enforcement Network, *Money Services Business (MSB) Information Center*, (Feb. 5, 2018), <https://www.irs.gov/businesses/small-businesses-self-employed/money-services-business-msb-information-center>.

[13] 31 CFR §1010.311; Financial Crimes Enforcement Network, *Money Services Business (MSB) Information Center*, (Feb. 5, 2018), <https://www.irs.gov/businesses/small-businesses-self-employed/money-services-business-msb-information-center>.

[14] 31 CFR §§1010.410, 415; 31 CFR §§1022.420, 380(a)(2).

[15] 31 CFR §1010.430.

[16] 31 CFR 1022.380(e); 31 U.S.C. § 5330(e); 18 U.S.C. § 1960(a) ("Whoever knowingly conducts, controls, manages, supervises, directs, or owns all or part of an unlicensed money transmitting business, shall be fined in accordance with this title or imprisoned not more than 5 years, or both."); 18 U.S.C. § 1960(b)(1)(B) ("A money transmitting business which affects interstate or foreign commerce in any manner or degree and fails to comply with the money transmitting business registration requirements under section 5330 of title 31, United States Code, or regulations prescribed under such section, shall be fined in accordance with this title or imprisoned not more than 5 years, or both.").