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FINANCIAL CRIMES ENFORCEMENT NETWORK ISSUES GUIDANCE ON VIRTUAL CURRENCY

DEBORAH S. THOREN-PEDEN, JIJI PARK, AMY L. PIERCE, AND ELSA S. BROEKER

FinCEN recently issued interpretive guidance to clarify that it views certain activities involving convertible virtual currencies as money transmission services under the Bank Secrecy Act and FinCEN regulations. Businesses that involve creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies may be subject to FinCEN's registration, reporting, and recordkeeping requirements.

The Financial Crimes Enforcement Network (“FinCEN”), under its authority to administer the Bank Secrecy Act (“BSA”), has issued interpretive guidance to clarify whether the BSA and its implementing regulations apply to persons using, administering, or exchanging virtual currencies (the “Guidance”).¹ The Guidance follows FinCEN’s issuance of a Final Rule amending definitions and other regulations relating to money services businesses (“MSBs”)² and a Final Rule amending definitions and other regulations relating to prepaid access.³ The Guidance explains the regulatory treatment of “persons” engaged in “convertible” virtual currency transactions under the BSA and its implementing regulations.

The Guidance clarifies the difference between “real currency,” which is “the coin and paper money of the United States or of any other country that

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is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance,” and “virtual currency,” which is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. The Guidance specifically addresses the regulatory treatment of “convertible virtual currency” and the “users,” “exchangers,” and “administrators” of convertible virtual currencies.

THE BSA AND IMPLEMENTING REGULATIONS

Under the BSA and its implementing regulations, MSBs, and authorized delegates of MSBs, are required, among other things, to develop, implement, and maintain policies, procedures, and internal controls that are reasonably designed to prevent the risk of money laundering and the financing of terrorist activities. These requirements include, among other things, establishing and maintaining a written anti-money laundering program and a customer identification program, filing government reports, creating and retaining records, and responding to law enforcement requests. The BSA’s implementing regulations define a “money services business” as “a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (ff)(1) through (ff)(7) of [31 C.F.R. § 1010.100],” one of which capacities is a money transmitter. In general, a “money transmitter” includes any person or entity that provides “money transmission services” or any other person engaged in the transfer of funds.⁴

The term “money transmission services” means the acceptance of currency, funds, or other value that substitutes for currency from one person *and* the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.⁵ “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.⁶

The Guidance notes that the definition of “money transmitter” does not differentiate between the transmission of real currencies and convertible virtu-

al currencies, which it defines as virtual currency that either has an equivalent value in real currency or acts as a substitute for real currency.

“USERS” OF VIRTUAL CURRENCY ARE NOT MSBS

Under the Guidance, a “user” of virtual currency is a person that obtains virtual currency to purchase goods or services. FinCEN recognizes that a person may “obtain” virtual currency by, for example, earning, harvesting, mining, creating, auto-generating, manufacturing, or purchasing it. The Guidance confirms that someone who only qualifies as a “user” of virtual currency is not an MSB under the BSA’s implementing regulations because such activity does not fit within the definition of “money transmission services.” Accordingly, a user of virtual currency is not subject to FinCEN’s registration, reporting, and recordkeeping requirements for MSBs.

CERTAIN “EXCHANGERS” AND “ADMINISTRATORS” OF VIRTUAL CURRENCY ARE MSBS

The Guidance defines an “exchanger” of virtual currency as a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency, and an “administrator” of virtual currency as a person engaged as a business in issuing (putting into circulation) a virtual currency, who also has the authority to redeem (to withdraw from circulation) such virtual currency. FinCEN concludes that, in contrast to “users” of virtual currency an “exchanger” or an “administrator” that accepts and transmits a convertible virtual currency or buys or sells convertible virtual currency for any reason is a “money transmitter” and therefore is an MSB under the BSA’s implementing regulations, unless the person qualifies for a limitation to or an exemption from the definition of a money transmitter.

The determination of whether a person is a money transmitter is a matter of facts and circumstances.⁷ However, the BSA’s implementing regulations specify that a person is not a money transmitter, despite accepting and transmitting currency, funds, or value that substitutes for currency, if such person only:

- (1) provides the delivery, communication, or network access services used by a money transmitter to support money transmission services;
- (2) acts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller;
- (3) operates a clearance and settlement system or otherwise acts as an intermediary solely between BSA-regulated institutions, including the Fedwire system, electronic funds transfer networks, certain registered clearing agencies regulated by the Securities and Exchange Commission, and derivatives clearing organizations, or other clearinghouse arrangements established by a financial agency or institution;
- (4) physically transports currency, other monetary instruments, other commercial paper, or other value that substitutes for currency as a person primarily engaged in such business from one person to the same person at another location or to an account belonging to the same person at a financial institution, provided that the person engaged in physical transportation has no more than a custodial interest in the currency, other monetary instruments, other commercial paper, or other value at any point during the transportation (e.g., an armored car);
- (5) provides prepaid access; or
- (6) accepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds.⁸

REGULATORY TREATMENT OF EXCHANGERS AND ADMINISTRATORS UNDER THREE SCENARIOS

FinCEN reviewed different activities involving convertible virtual currency and provided guidance regarding the appropriate regulatory treatment of exchangers and administrators of convertible virtual currency under three scenarios: (1) brokers and dealers of e-currencies and e-precious metals, (2) centralized convertible virtual currencies, and (3) de-centralized convertible virtual currencies.

Brokers and Dealers of E-Currencies and E-Precious Metals

Electronic trading in e-currencies or e-precious metals typically involves a broker or dealer electronically distributing digital certificates of ownership of real currencies, precious metals, or other commodities, with the digital certificate being the virtual currency. It may also include a broker or dealer issuing paper ownership certificates or manifesting customer ownership or control of real currencies or commodities in an account statement or any other form. The Guidance clarifies that a broker or dealer of e-currencies and e-precious metals that engages in money transmission services could either be an exchanger or administrator of convertible virtual currency depending on its business model and thus an MSB under the BSA's implementing regulations.

Centralized Convertible Virtual Currencies

FinCEN analyzed the scenario where convertible virtual currency has a centralized repository, and FinCEN concluded that the administrator of such a repository is a money transmitter and therefore is an MSB under the BSA's implementing regulations to the extent that the administrator allows transfers of value between persons or from one location to another, regardless of whether the value is denominated in a real currency or a convertible virtual currency. In addition, the Guidance provides that an exchanger of convertible virtual currency that uses its access to the convertible virtual currency services provided by the administrator to accept and transmit the convertible virtual currency on behalf of others, including transfers intended to pay third parties for virtual goods and services, is also a money transmitter and therefore is an MSB under the BSA's implementing regulations.

FinCEN stated that an exchanger's activities may occur in one of two scenarios. The first scenario would involve an exchanger (acting as a "seller" of the convertible virtual currency) that accepts real currency or its equivalent from a user (the "purchaser") and transmits the value of that real currency to fund the user's convertible virtual currency account with an administrator. Under the BSA's implementing regulations, a person that sends "value that substitutes for currency" to another person or to another location is a money transmitter, unless an exclusion from the definition of a money transmitter applies.

The second scenario would involve a *de facto* sale of convertible virtual currency that is not completely transparent. For example, an exchanger accepts currency or its equivalent from a user and privately credits the user with a portion of the exchanger's convertible virtual currency held with an administrator of the repository and then transmits that credited value to third parties at the user's direction. To the extent that the convertible virtual currency is generally understood to be a substitute for real currencies, the Guidance provides that an exchanger's transmission of it at the direction and for the benefit of the user constitutes money transmission under the BSA's implementing regulations.

De-Centralized Convertible Virtual Currencies

The Guidance identifies an additional type of convertible virtual currency activity that involves de-centralized convertible virtual currency, which is convertible virtual currency that: (1) persons obtain by their own computing or manufacturing effort; and (2) has no central repository and no single administrator. The Guidance confirms that a person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is therefore a money transmitter and an MSB under the BSA's implementing regulations. In addition, a person who accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency is an exchanger of convertible virtual currency and therefore a money transmitter and an MSB under the BSA's implementing regulations.

WHAT THE GUIDANCE MAY MEAN

If a business involves creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies, it may be an MSB under the BSA's implementing regulations and subject to FinCEN's registration, reporting, and recordkeeping requirements for MSBs.

NOTES

¹ See http://fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html.

² 76 F.R. 43585 (July 21, 2011).

³ 76 F.R. 45403 (July 29, 2011).

⁴ See 31 C.F.R. § 1010.100(ff)(5).

⁵ *Id.*

⁶ *Id.*

⁷ 31CFR § 1010.100(ff)(5)(ii).

⁸ 31 CFR § 1010.100(ff)(5)(ii). It is important to note that even if the business does not qualify as a “money transmitter” it may still be deemed to be an MSB under the BSA and subject to broad anti-money laundering requirements under one of the other types of business covered as an MSB; for example, it may be covered by the prepaid access provisions in the BSA.