FINCEN GUIDANCE ON VIRTUAL CURRENCIES

I. BACKGROUND

The Financial Crimes Enforcement Network (FinCEN) has released interpretive guidance concerning the application of the Bank Secrecy Act (BSA) and the anti-money laundering (AML) regulations to certain business models involving virtual currencies.

FinCEN notes that the guidance does not create any new regulatory obligations, but that it is instead a compilation of the agency’s previously released administrative rulings and other guidance in this area to furnish industry participants with additional clarity about FinCEN’s approach to regulating such virtual currency–related products, services, and service providers as peer–to–peer (P2P) exchangers, virtual wallets, kiosks, decentralized applications (DApps) and anonymity–enhanced transactions, payment processors, and online casinos.

FinCEN defines convertible virtual currencies (CVCs) as “value that substitutes for currency.” FinCEN also states that “exchangers” and “administrators” of CVC’s are generally considered money transmitters subject to registration with FinCEN as a money services business (MSB). In contrast, “users” of CVC’s are not MSBs. The guidance also describes how FinCEN regulations apply to particular business models involving CVC transmission, including:

- P2P exchangers;
- CVC wallets and their providers;
- CVC kiosks (i.e., ATMs or vending machines);
- DApps and their owners and operators;
- Anonymity–enhanced CVC transactions;
- CVC payment processors; and
- Online casinos.

Additionally, the guidance addresses a number of notable exemptions to the FinCEN regulations, including, among others, those that apply to CVC trading platforms, initial coin offerings (ICO's) involving CVC, and CVC creators.
II. APPLICATION TO PARTICULAR BUSINESS MODELS

A. P2P Exchangers

FinCEN explains that P2P exchangers are usually natural persons who are in the business of buying and selling CVCs, including facilitating transfers of one CVC to another CVC and exchanging CVC for other monetary value such as real currency. According to FinCEN, a P2P exchanger conducting these kinds of transactions is a money transmitter acting as a principal and must register with FinCEN as an MSB, regardless of the frequency or formality of the transaction or where the exchanger is located. FinCEN indicates further that natural persons conducting these activities infrequently and not for profit or gain are exempted.

B. CVC Wallets

FinCEN distinguishes between “hosted” and “un-hosted” CVC wallet providers. According to FinCEN, hosted wallet providers receive, store, and transfer CVC on behalf of accountholders typically online or through mobile applications. FinCEN indicates that, in this particular business model, “the money transmitter is the host, the account is the wallet, and the accountholder is the wallet owner.” FinCEN states that the regulatory requirements ascribed to the host will vary depending upon the wallet owner’s status as a nonfinancial institution, agent, or U.S. or foreign counterparty, and on the nature of the transaction and its U.S. dollar equivalent. Likewise, FinCEN notes that its regulatory treatment of transactions that host channels from or for wallet owners will also depend upon the type of those specific transactions.

Additionally, FinCEN defines un-hosted wallets as software on a computer, phone, or other device that enables persons to hold CVC and engage in CVC transactions. For this particular business model, FinCEN notes that another third party is not required for such transactions. According to FinCEN, to the extent that “the person conducting a transaction through the un-hosted wallet is doing so to purchase goods or services on the user's own behalf, they are not a money transmitter.”

FinCEN explains that multi-signature wallet providers enable the establishment of CVC wallets that require multiple private keys for wallet owners to carry out transactions. In this regard, when a multi-signature wallet provider limits its role to the creation of un-hosted wallets that require the addition of a second authorization key to the wallet owner’s private key to complete transactions, FinCEN states that this wallet provider is not accepting and transmitting value so it is not a money transmitter. However, FinCEN indicates that an entity is a money transmitter if it conflates the services of multi-signature wallet providers with those of hosted wallet providers. Further, FinCEN notes in the guidance that a multi–signature wallet provider is a money transmitter if “the value is represented as an entry in the accounts of the provider, the owner does not interact with the payment system directly, or the provider maintains total independent control of the value.”
C. **CVC Kiosks**

According to FinCEN, owners and operators of CVC kiosks that utilize electronic terminals to receive real currency from consumers and to transfer the equivalent value in CVC (or vice versa) are deemed to be money transmitters. In addition, the guidance also restates FinCEN’s view that owners and operators of ATMs that link account holders with their respective accounts held with regulated banks for the sole purpose of verifying account balances and dispensing currency are not considered money transmitters.

D. **DApps**

FinCEN states that, when DApps (i.e., software on a P2P network of computers operating on a Blockchain platform) accept and transfer value, the definition of money transmitter under the FinCEN regulations will apply to the DApp, its owners and operators or both, as is also the case with CVC kiosks.

E. **Anonymity-enhanced CVC Transactions**

The guidance includes a more thorough discussion of anonymizing services than FinCEN has previously provided. In particular, FinCEN explains that anonymity–enhanced CVC transactions are denominated in “regular types of CVC” specifically structured to conceal information that is otherwise available on the CVC’s native distributed public ledger or to prevent their tracing through such ledgers. Among other things, FinCEN details how its regulations apply to anonymizing service providers, anonymizing software providers, and anonymity–enhanced CVC providers. Specifically, FinCEN states that anonymizing service providers that receive and re–transmit CVC in a way that prevents tracing the source of that transmission are considered money transmitters. FinCEN mentions that anonymizing software providers are excepted because they are engaged in the trade of furnishing “the delivery, communication, or network access services used by a money transmitter to support money transmission services,” and are not themselves conducting money transmission. Moreover, FinCEN indicates that anonymity–enhanced CVC providers (creators or sellers of such CVC) would be money transmitters depending upon the nature of the payment system and the activity.

F. **CVC Payment Processors**

FinCEN also mentions that CVC payment processors are money transmitters and may not avail themselves of FinCEN’s payment processor exemption from MSB registration. One of the four conditions of this exemption—all of which must be met—is that the entity must “operate through clearance and settlement systems that admit only BSA-regulated financial institutions.” According to FinCEN, CVC payment processors are generally unable to meet this condition and are thus money transmitters “regardless of whether they accept and transmit the same type of CVC, or they accept one type of value (such as currency or funds) and transmit another (such as CVC).”
G. Online Casinos

FinCEN restates the definition of “casino, gambling casino, or card club” under the FinCEN regulations as entities that are “licensed or authorized to do business as such in the United States... [and have] gross annual gaming revenue in excess of $1 million, whether denominated in CVC or other value.” (According to FinCEN, online casinos include “predictive markets, information markets, decision markets, idea futures, and event derivatives.”) FinCEN states that entities in the business of gambling that is not within the scope of this definition of casino could still be deemed money transmitters if they nonetheless receive and transfer value denominated in CVC. FinCEN indicates that this is true even when the initial transmission or disbursement occurs when a particular event happens, in which case money transmission takes place when that condition is satisfied and the receipt or transfer occurs.

III. EXEMPTIONS

A. Trading Platforms

FinCEN states that in a scenario in which a CVC trading platform “only provides a forum where buyers and sellers of CVC post their bids and offers... and the parties themselves settle any matched transactions through an outside venue,” the trading platform is not a money transmitter. However, FinCEN makes clear that a trading platform is acting as a CVC exchanger and is therefore a money transmitter if, when transactions are matched, the platform itself buys CVC from a seller and sells it to a buyer.

B. ICOs

In a circumstance where an ICO consists of the sale of CVC to a group of preferred buyers, FinCEN considers the seller to be acting as an administrator and, consequently, a money transmitter. This is because, “at the time of the initial offering the seller is the only person authorized to issue and redeem... the new units of CVC.” The guidance also addresses the fact-specific application of the FinCEN regulations to the use of ICOs to raise funds for development projects by offering digital debt or equity instruments or by conducting certain hedging activities.

Moreover, FinCEN indicates that DApp developers are not money transmitters merely by creating an application to issue a CVC or by otherwise enabling financial transactions denominated in CVC. According to FinCEN, such a developer would have to use that DApp to conduct money transmission in order to be considered a money transmitter.

C. CVC Creators

FinCEN explains that, insofar as an entity mines CVC and only uses it to buy goods and services for its own behalf, that entity is not an MSB. FinCEN also states that, if that entity’s activities includes the acceptance or transmission of CVC, however, it would be subject to the FinCEN regulations.
Concurrently, with the release of its guidance, FinCEN also issued an advisory entitled “Advisory on Illicit Activity Involving Convertible Virtual Currency,” which details potential risks, types of abuses and their indicators, and suspicious activity reporting that may arise from CVC transactions, which may be located at https://www.fincen.gov/sites/default/files/advisory/2019-05-10/FinCEN%20Advisory%20CVC%20FINAL%20508.pdf.