

VIRTUAL CURRENCIES WITH REAL IMPLICATIONS: FINCEN'S FIRST ENFORCEMENT ACTION AGAINST A FOREIGN-LOCATED MONEY SERVICES BUSINESS

On July 26, 2017, the U.S. Department of Justice (DOJ) and the Treasury Department's Financial Crimes Enforcement Network (FinCEN) assessed a \$110,003,314 civil money penalty against BTC-e (aka Canton Business Corporation), a foreign Money Services Business (MSB), and a \$12,000,000 penalty against Russian national Alexander Vinnik, an operator of BTC-e. BTC-e was fined for willfully violating United States anti-money laundering (AML) laws. This was FinCEN's first enforcement action against a foreign-based MSB, and its second action against a virtual currency operator.

In a coordinated effort between FinCEN and the DOJ, Vinnik was indicted for operation of an unlicensed MSB, conspiracy to commit money laundering, money laundering, and engaging in unlawful monetary transactions. The indictment alleges Vinnik owned and operated multiple BTC-e accounts and was the main beneficial owner of Canton Business Corporation, BTC-e's managing shell company. Additionally, withdrawals from BTC-e administrator accounts frequently went to Vinnik's personal bank accounts. He was arrested in Greece on July 25, 2017, and faces a maximum of 55 years in prison.

BTC-e is one of the world's biggest internet-based virtual currency exchanges, handling Bitcoin, Litecoin, Namecoin, Novacoin, Peercoin, Ethereum, and Dash. According to the Assessment, BTC-e processed transactions involving ransomware, computer hacking, identity theft, tax refund fraud schemes, public corruption, stolen funds, and drug trafficking. BTC-e deliberately failed to obtain mandated information from customers which facilitated the persistent criminal activity carried out on the exchange. Furthermore, the company suggested ways to process and access illegally obtained money (through illicit drug sales) through its customer service agents.

MSBs have registration requirements and must comply with numerous AML regulatory requirements, including implementing an AML compliance program,

reporting suspicious activities, as well as other recordkeeping and reporting responsibilities.

MSBs that Conduct Substantial Business in the United States must Comply with US MSB Rules and Regulations

Although BTC-e was not located in the United States, it conducted over \$296 million in transactions of Bitcoin, and tens of thousands of transactions in other convertible virtual currencies between customers and receivers located within the U.S. Under U.S. Law, a MSB is defined as any 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 several enumerated capacities, including as a money transmitter.¹ It is not entirely clear when a foreign-located business should be deemed to be doing business as an MSB "in substantial part within the United States,"² but FinCEN appears to be interpreting broadly the meaning of "in substantial part." FinCEN asserted jurisdiction over BTC-e without much analysis of whether BTC-e's business was conducted in substantial part in the United States by merely noting that: (i) BTC-e's customers located within the United States used BTC-e to conduct at least 21,000 Bitcoin transactions worth over \$296,000,000 and tens of thousands of transactions in other convertible virtual currencies; (ii) the transactions included funds sent from customers located within the United States to recipients who were also located within the United States; and (iii) these transactions were processed through servers located in the United States. In a statement by Jamal El-Hindi, FinCEN's acting director, he made clear that FinCEN is committed to holding foreign-located money transmitters accountable when they disregard and fail to comply with U.S. AML laws and regulations.

Virtual Currency Administrators and Exchangers are MSBs under U.S. Law

In 2013, FinCEN issued guidance to provide more clarity for businesses interested in the virtual currency industry. The guidance defined certain businesses and individuals as MSBs based on their financial activities, and clarified that an "administrator" or "exchanger" of virtual currency is an MSB under FinCEN regulations, specifically a money transmitter.³

In 2014, FinCEN issued two administrative rulings that provide additional insight into the kind of conduct with virtual currency that constitutes a money transmitter under U.S. federal law. The first ruling clarified that an entity that mines virtual currency and uses it to pay a merchant qualifies as a money transmitter (unless the user creates or mines a virtual currency solely for his own personal purpose).⁴ The second ruling found that setting up a "platform" that automatically and anonymously matches purchasers to sellers meets the definition of money transmission.⁵

¹ 31 C.F.R. § 1010.100(ff).

² 6 31 U.S.C. §§ 5312(a)(6), 5312(b), and 5330(d); 31 C.F.R. § 1010.100(ff).

³ Unless a limitation or exemption applies to the business or individual.

⁴ *Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Payment System*, FIN-2014-R012 (October 27, 2014), located at: <https://www.fincen.gov/resources/statutes-regulations/administrative-rulings/request-administrative-ruling-application>

⁵ *Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Trading Platform*, FIN-2014-R011 (October 27, 2014), located at: <https://www.fincen.gov/resources/statutes-regulations/administrative-rulings/request-administrative-ruling-application-0>

By 2015, FinCEN assessed a civil money penalty in the amount of \$700,000 against Ripple Labs Inc.,⁶ an online platform for exchanging virtual currency and other assets. Ripple Labs Inc. was fined for failure to register as an MSB, failure to implement and maintain effective AML programs, and failure to maintain required records. Even though Ripple Labs Inc. had not properly registered as an MSB, it was still subject to anti-money laundering laws and regulations applicable to MSBs, including the AML program requirement, reporting, record-keeping, employee trainings, and independent reviews.

Conclusion

Individuals and businesses engaged in the virtual currency industry, even if not located in the United States, should review their activities, and, if such activities involve transactions with persons in the United States and/or are effected through servers located in the United States, should ensure they are in compliance with the relevant U.S. laws and regulations. As evident in the Ripple Labs Inc. and BTC-e enforcement actions, failure to comply with the registration requirements, maintain an effective AML compliance program, or meet ongoing reporting and record-keeping requirements may result in significant civil and criminal penalties for both the entity and its operators.

⁶ XRP II LLC Ripple Labs Inc.'s wholly owned subsidiary was also implicated.

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