

## TREASURY ISSUES FIRST-EVER SECTION 9714 ORDER PROHIBITING TRANSMITTAL OF FUNDS INVOLVING BITZLATO

On January 18, 2023, the U.S. Department of the Treasury ("Treasury")'s Financial Crimes Enforcement Network ("FinCEN") issued an order identifying Bitzlato Limited ("Bitzlato"), a virtual asset service provider, as a "primary money laundering concern" in connection with Russian illicit finance and prohibiting certain transmittals of funds by any covered financial institution involving Bitzlato pursuant to the Combatting Russian Money Laundering Act ("CRMLA").<sup>1</sup> The action was taken in conjunction with the FBI's arrest of Bizlato's founder Anatoly Legkodymov. As the Deputy Secretary of the Treasury commented at the subsequent press conference, this action is "the first of its kind specifically under new authorities to combat Russian illicit finance," also noting that "identifying Bitzlato as a 'primary money laundering concern' effectively renders the exchange an international pariah."<sup>2</sup>

### STATUTORY AUTHORITY - SECTION 9714

Under Section 9714, Treasury can impose broader prohibitions in connection with Russia-related primary money laundering concerns than previously authorized with respect to other primary money laundering concerns, going beyond the prohibitions available under Section 311 of the USA PATRIOT Act. Section 9714(a) provides that when Treasury determines that one or more financial institutions operating outside the United States is of primary money laundering concern in connection with Russian illicit finance, Treasury may, by order, regulation, or otherwise as permitted by law: (1) require domestic financial institutions and domestic financial agencies to take one or more of the special measures described in 31 U.S.C. § 5318A(b), i.e., the traditional Section 311 measures; or (2) with the CRMLA-based expanded authority, "prohibit or impose

<sup>1</sup> CRMLA itself is part of National Defense Authorization Act ("NDAA") of 2021. See NDAA §§ 9711 et seq.

<sup>2</sup> See <https://home.treasury.gov/news/press-releases/jy1193>.

conditions upon, certain transmittals of funds (to be defined by the Secretary) by any domestic financial institution or domestic financial agency, if such transmittal of funds involves any such institution."<sup>3</sup>

The traditional Section 311 measures include imposing additional recordkeeping, information collection, and reporting requirements on covered financial institutions. With respect to prohibitions, however, Section 311's most commonly used measure, Special Measure No. 5, only allows Treasury to prohibit, or impose conditions upon, the opening or maintaining in the United States of correspondent or payable-through accounts by domestic financial institutions. See [here](#) for a detailed explanation of Section 311 authorities.<sup>4</sup> The CRMLA authority essentially adds the ability to prohibit any type of transmittal of funds by any type of US financial institution as Treasury deems warranted, and Treasury may do so without going through a rulemaking process.

In this case, the imposed special measure against Bitzlato is an order prohibiting transmittals of funds involving Bitzlato by any covered financial institution. As FinCEN explained in the accompanying FAQ, a "covered financial institution," meaning a financial institution required to comply with this order, would be any domestic financial institution as defined in 31 C.F.R. § 1010.100(t), which includes banks, broker/dealer in securities, money service businesses, futures commission merchant, introducing brokers in commodities and mutual funds, among others.<sup>5</sup> Covered financial institutions are not limited to those that have the capacity to offer correspondent relationships, as is the case when FinCEN imposes prohibitions under Special Measure No. 5 of Section 311.<sup>6</sup>

## **FINCEN'S FINDING REGARDING BITZLATO**

FinCEN determined that Bitzlato, a peer-to-peer ("P2P") convertible virtual currency ("CVC") exchanger, is a financial institution of primary money laundering concern in connection with Russian illicit finance based in large part on its high level of involvement in ransomware payments and other illicit activities, including "a significant transaction history with the Russia-connected Hydra darknet marketplace," in comparison with other CVC exchangers. The finding cites various blockchain analytics<sup>7</sup> to demonstrate the comparative risks quantitatively. FinCEN also notes that the permissive quality of Bitzlato's KYC practices, as advertised on Bitzlato's website, effectively increased the likelihood of its use for illicit activity. The FinCEN Order also provides some details on Bitzlato's most common counterparties.<sup>8</sup>

<sup>3</sup> See <https://www.congress.gov/116/bills/hr6395/BILLS-116hr6395enr.pdf>.

<sup>4</sup> See [https://www.fincen.gov/sites/default/files/shared/Order\\_Bitzlato\\_FINAL%20508.pdf](https://www.fincen.gov/sites/default/files/shared/Order_Bitzlato_FINAL%20508.pdf).

<sup>5</sup> See [https://www.fincen.gov/sites/default/files/shared/FAQs\\_Bitzlato%20FINAL%20508.pdf](https://www.fincen.gov/sites/default/files/shared/FAQs_Bitzlato%20FINAL%20508.pdf).

<sup>6</sup> See 31 C.F.R. § 1010.100(t); 31 U.S.C. §5318A(b)(5).

<sup>7</sup> For more information on blockchain analytics, please see our prior client briefing at [https://www.cliffordchance.com/briefings/2019/09/busting\\_bitcoin\\_sanonymity-theimplication.html](https://www.cliffordchance.com/briefings/2019/09/busting_bitcoin_sanonymity-theimplication.html).

<sup>8</sup> The Order indicates that approximately two-thirds of Bitzlato's top receiving and sending counterparties are associated with darknet markets or scams. Bitzlato's top three receiving counterparties were (1) Binance; (2) Hydra, the Russia-connected darknet market; and (3) "The Finiko," the alleged Russia-based Ponzi scheme. Bitzlato's top three sending counterparties included (1) Hydra; (2) Local Bitcoins, a VASP based in Finland; and (3) "The Finiko."

## **THE IMPOSED PROHIBITION AND RECOMMENDED COMPLIANCE MEASURES**

Pursuant to Section 9714(a)(2), FinCEN imposed a special measure prohibiting any covered financial institution from engaging in a transmittal of funds from or to Bitzlato, or from or to any account or CVC address administered by or on behalf of Bitzlato. To comply with this prohibition, FinCEN noted that covered financial institutions should: (1) cease any and all transmittals of funds, including CVC, from or to Bitzlato, or from or to any account or CVC address administered by Bitzlato; and (2) incorporate the determination that Bitzlato is of primary money laundering concern into their AML/CFT compliance programs. FinCEN recommends that covered financial institutions continue to implement appropriate AML/CFT procedures and systems, including traditional compliance screening and blockchain tracing software, to identify their customers and determine whether they are involved in a transmittal of funds involving Bitzlato.<sup>9</sup>

In the event that a covered financial institution cannot proactively prevent the receipt of CVC from Bitzlato due to technological constraints, the order offers them limited flexibility to decide how to handle such inbound transfers, or from an account or CVC address administered by or on their behalf. Specifically, FinCEN notes that a covered financial institution will be deemed not to have violated this order where, upon determining that it received CVC that originated from Bitzlato, the covered financial institution rejects the transaction by: (1) preventing the intended recipient from accessing such CVC; and (2) returning the CVC to Bitzlato, or to the account or address from which it originated. Importantly, covered financial institutions may only reject transactions in the form of CVC, not fiat currency.<sup>10</sup>

## **IMPLICATION OF THIS ACTION**

Although this is the agency's first Section 9714 action, FinCEN's use of this authority to combat primary money laundering concerns has been long expected, as it provides FinCEN more effective tools to quickly tackle any identified foreign money laundering concerns concerning Russia without undue delay.

As noted above, Section 9714 provides FinCEN complete authority to define what constitutes "transmittals of funds" in a special measure issuance, by regulation, order, or as otherwise permitted by law. Essentially, with this broad discretion, FinCEN can name any transaction that involves a foreign jurisdiction "a transmittal of funds," and prohibit it (e.g., cryptocurrency transfers) from any domestic financial institution. Cryptocurrency transfers (like CVC transactions) do not generally require correspondent banking services or foreign banks. Therefore, Section 9714 avoids the limitations of Special Measure No. 5 under Section 311 and provides FinCEN a new category of authority to target cryptocurrency money laundering, at least as it relates to Russia. In addition, as FinCEN can take a Section 9714 action via an order without the need of a rulemaking process, the agency can move quickly to identify and effectively isolate primary money laundering concerns in the industry, which is often time-sensitive in the digital age.

<sup>9</sup> See [https://www.fincen.gov/sites/default/files/shared/FAQs\\_Bitzlato%20FINAL%20508.pdf](https://www.fincen.gov/sites/default/files/shared/FAQs_Bitzlato%20FINAL%20508.pdf).

<sup>10</sup> *Id.*

Given that Section 9714 provides for broader prohibitive authorities with respect to Russia-related primary money laundering concerns, both US and foreign financial institutions should be prepared for future Section 9714 actions. A larger range of financial institutions, including money services business, need to consider the system needs necessary to comply with future orders, including the ability to put themselves in a position to reject CVC transfers if they are not already capable of easily doing so. Industry may also consider the likelihood that this new type of authority could be applied in future contexts other than those involving Russia. Legislation has already been proposed to amend Section 311 in a way that would include the broader authority now only existing under Section 9714 for use with respect to situations involving Russia.

Financial institutions should also read the FinCEN [FAQs](#) for an understanding of FinCEN's expectations on how they need to comply with the prohibitions. Finally, CVC exchangers and other virtual asset service providers operating outside the United States should take note of the way FinCEN compared Bitzlato's activities to others through the use of blockchain analytics and an assessment of the Bitzlato's minimal KYC activities when singling out Bitzlato for Section 9714 treatment. When assessing whom they should or should not do business with, institutions seeking to demonstrate strong AML compliance may be expected to use a similar methodology for risk-rating the entities with which they engage.

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