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Tying It All Together: FinCEN Consolidates Several Years of Cryptocurrency Guidance

For the past several years, advocates of crypto assets and other public uses of blockchain technology have sought guidance from U.S. regulators regarding the legal implications of new or novel uses of that technology. Regulators initially responded by addressing key topics in a piecemeal fashion through informal guidance, public statements, and sometimes targeted enforcement actions. More recently, several have published broader summaries of their views on how these technologies and the marketplaces built around them fit within the pre-existing regulatory framework.¹

Earlier this month, the Financial Crimes Enforcement Network (“FinCEN”) issued the latest and perhaps the clearest guidance yet. Released on May 9, 2019, FinCEN’s guidance (“May 2019 Guidance”) “consolidates current FinCEN regulations, and related administrative rulings and guidance issued since 2011, and then applies these rules and interpretations to other common business models.”² Only time will tell if Congress or individual States will enact new legislation affecting the regulation of crypto assets.³ In the meantime, both new entrants to the market and established financial institutions branching out into crypto assets would be wise to take note of this guidance from FinCEN and assess whether aspects of their business models, products, and services bring them under FinCEN’s jurisdiction and, in particular, subject them to Bank Secrecy Act (“BSA”) requirements as money service businesses (“MSBs”).

BACK TO DEFINITIONS

FinCEN’s May 2019 Guidance begins by going back to basics, with a section explaining the terms of art that connect certain crypto-related business models to established FinCEN jurisdiction. In short, FinCEN views the acceptance or transmission of crypto assets as “money transmission services,” provided that the crypto assets constitute “other value that substitutes for currency.”⁴ Any person or business who provides such money transmission services is deemed a “money transmitter,” and therefore a MSB.⁵ Based on authority derived from the BSA, FinCEN



requires that MSBs register and comply with various regulations, including establishing an anti-money laundering (“AML”) program that is reasonably designed to prevent the MSBs from being used to facilitate money laundering or the financing of terrorist activities. The regulations also require compliance with rules around customer identification, transaction monitoring, currency reporting, suspicious activity reporting, and recordkeeping.⁶

Of course, to qualify as a MSB and be subject to BSA/AML requirements, the underlying transactions processed by a business must be in some “other value that substitutes for currency.” FinCEN generally views cryptocurrency and other crypto assets, which the agency calls convertible virtual currencies (“CVCs”), as meeting this definition.

FinCEN reasons that the substance of the transferred item, not its label, is what truly matters, taking a functional approach to CVCs. According to the May 2019 Guidance, CVCs include any cryptocurrency whether or not it was originally created for a different purpose — so long as it was “repurposed” as a currency substitute.⁷ FinCEN states: “[T]he label applied to any particular type of CVC (such as ‘digital currency,’ ‘cryptocurrency,’ ‘cryptoasset,’ ‘digital asset,’ etc.) is not dispositive of its regulatory treatment.” The Guidance re-iterates a similar substance-over-form approach to the definition of a MSB subject to BSA regulation, noting that it “depends on the [individual’s or entity’s] *activities* and not its formal business status.”⁸

TREATMENT OF COMMON CRYPTO-RELATED BUSINESS MODELS

Section 4 of the May 2019 Guidance walks through a number of common products and services within the crypto industry, pointing out the attributes that lead FinCEN to conclude certain businesses models are MSBs, and thus subject to FinCEN’s jurisdiction. FinCEN also carves out others that either do not qualify as MSBs or are exempt from FinCEN’s oversight.⁹

- **Peer-to-Peer (“P2P”) Exchangers** — Individuals or services engaging in buying and selling CVCs (exchanging one type of CVC for another CVC or other types of value) are MSBs. An exception exists for natural persons engaging in P2P exchange activity infrequently and “not for profit or gain.”¹⁰
- **CVC Wallets** — The May 2019 Guidance lays out four criteria for determining whether a wallet provider must register as a MSB: (a) who owns the value; (b) where the value is stored; (c) whether the owner interacts directly with the payment system where the CVC runs; and, (d) whether the person acting as intermediary has total independent control over the value.¹¹ For example, providers and users of “unhosted” wallets — software on a person’s device enabling them to conduct transactions in CVC — are not money transmitters so long as the wallets are used to purchase goods or services on the user’s own behalf. On the other hand, “hosted” wallets — account-based money transmitters that receive, store, and transmit CVCs on behalf of their accountholders — do qualify as money transmitters. The regulatory framework for these hosts can vary depending on the identity of the wallet owner and the type of transactions channeled through the hosted wallet.¹²
- **CVC Kiosks** — An owner-operator of a CVC kiosk that accepts currency from a customer and transmits the equivalent value in CVC back to the customer (or vice versa) qualifies as a money transmitter. Owner-operators of kiosks that merely verify account balances and dispense currency without converting it, however, are not money transmitters.¹³
- **Decentralized Applications (“DApps”)** — FinCEN defines DApps as “software programs that operate on a P2P network of computers running a blockchain platform,” noting that DApps have no identifiable administrators controlling them. In the case of DApps that accept and transmit value, FinCEN applies the same regulatory interpretation used for mechanical systems like CVC kiosks: owner-operators of DApps — and possibly the DApps themselves — meet the definition of MSBs when those DApps perform money transmissions.¹⁴



- **Anonymizing Services/Software** — The Guidance delineates between providers of anonymizing *services* and anonymizing *software*. Anonymizing services providers are money transmitters under FinCEN regulations, because the additional feature of concealing the source of the transaction does not change the fact that providers' business consists exclusively of providing secured money transmission, thereby subjecting it to BSA obligations. On the other hand, FinCEN exempts anonymizing software providers from the definition of MSBs because they supply a tool "utilized in money transmission" and are therefore engaged in trade rather than the business of money transmission. By contrast, a person who uses the software in order to engage as a business in the acceptance and transmission of CVCs as a transmitter's or intermediary's financial institution would be a money transmitter.¹⁵
- **Anonymity-Enhanced CVCs** — Those who create or sell CVCs that themselves enhance anonymity in some way may be money transmitters to the extent the creators/sellers provide those CVCs in exchange for another type of value. If the creator of an anonymity-enhanced CVC merely uses it to pay for goods or services on its own behalf, however (perhaps by establishing a decentralized CVC payment system and then only participating by mining their own CVC units and then using the system to make payments with those CVC units), they would not qualify as a money transmitter.¹⁶
- **Payment Processors** — CVC payment processors are generally money transmitters. They are not eligible for FinCEN's standard payment processor exemption because, among other reasons, the payment processor exemption only applies to systems that limit their membership to Bank Secrecy Act-regulated financial institutions. This limitation is one that few, if any, CVC payment processors currently meet.¹⁷
- **Internet Casinos** — Even operations engaged in the business of gambling that are not otherwise covered by the regulatory definitions of casino, gambling casino, or card club, but that accept and transmit CVC, might qualify as money transmitters.¹⁸

FinCEN's Guidance highlighted several business models that may not qualify as MSBs (e.g., trading platforms or decentralized exchanges that provide a forum for parties to post bids and offers but that require the parties to settle through an outside venue, or miners who use the resulting CVC solely to purchase goods or services on their own behalf). The Guidance also identified other individuals and entities as exempt from FinCEN's oversight because they are already subject to another regulator's jurisdiction (e.g., issuers, intermediaries, investors and others involved in initial coin offerings ("ICOs") that are regulated by the Commodities Futures Trading Commission or Securities and Exchange Commission).¹⁹

INITIAL COIN OFFERINGS ("ICOs")

FinCEN's Guidance also addresses the application of the BSA to two broad categories of ICOs, but acknowledges that these do not encompass every possible ICO structure.

First, where an ICO consists of a CVC sale to a select group of buyers, FinCEN determined that the seller of the CVC is a money transmitter, regardless of whether the value obtained from the offering is made instantaneously or at some later date. FinCEN explained that this reflects the seller's role as "the only person authorized to issue and redeem (permanently retire from circulation) the new units of CVC."²⁰

Under the second business model involving an ICO, where the participant is raising funds by selling tokens as an equity stake or debt instrument to early stakeholders to finance a project or hedge a prior investment in CVC through a derivatives contract, the May 2019 Guidance explains that the regulatory treatment may vary depending on what happens to the tokens as the project develops. Generally speaking, issuers and intermediaries (or investors) that are banks, foreign banks, or otherwise functionally regulated by the SEC or CFTC are exempt from MSB status.²¹ In



addition, any sale of a security, including debt instruments, will be regulated by the SEC and therefore exempt from FinCEN jurisdiction. Once an investor holds a digital token or derivative, a re-sale “will not create any BSA obligations.”²²

EARLY TO THE PARTY

FinCEN’s latest guidance is a helpful summary of several years of iterative guidance. With key guidance dating back to March 2013,²³ FinCEN was one of the first agencies to describe how it would regulate cryptocurrency. The agency was also one of the first to bring enforcement actions against crypto-related operations.

In May 2015, FinCEN assessed a \$700,000 civil money penalty against Ripple Labs, Inc. for selling its cryptocurrency without registering as a MSB, failing to implement an adequate AML program, and failing to file suspicious activity reports (“SARs”).²⁴ In July 2017, FinCEN assessed a \$110 million penalty against the foreign-based currency exchange BTC-e, along with a \$12 million penalty against its principal, Alexander Vinnik, in connection with allegations of willful failures to register as a MSB, implement an adequate AML program, and file SARs.²⁵ As part of what FinCEN viewed as its evasion of compliance with BSA requirements, BTC-e allegedly tried to conceal that it was servicing customers in the United States. More recently, just last month, FinCEN for the first time assessed a civil monetary penalty against a peer-to-peer virtual currency exchanger named Eric Powers for his involvement in numerous darknet transactions, including business on the infamous darknet marketplace Silk Road.²⁶ FinCEN fined Powers \$35,000 for failing to register as a MSB, failing to establish an adequate anti-money laundering program, and failing to file CTRs and SARs.

While FinCEN has not pursued as many crypto-related enforcement actions as the SEC,²⁷ its recent guidance gives no indication that FinCEN’s interest in crypto assets is waning. Its recent action against an individual currency exchanger in the peer-to-peer space underscores that FinCEN is continuing to monitor ways in which crypto-related business models are running afoul of its established rules governing MSBs.

ROADMAP FOR ASSESSING NEW BUSINESS MODELS

Following a flurry of targeted statements and enforcement actions over the past few years, summary guidance helps agencies like FinCEN to present their views of how the various pronouncements come together as a whole. While not breaking new ground, summaries like these provide concrete roadmaps for business professionals to apply when assessing whether their products and services in the virtual currency area are subject to oversight by particular regulators.

The recent rally in cryptocurrency markets could soon lead entrepreneurs and established financial institutions to increase their focus on cryptocurrency projects.²⁸ In that case, business professionals launching crypto operations or otherwise expanding into the digital asset marketplace should look to this new guidance from FinCEN as a consolidation of the rules and guiding principles that FinCEN will use to evaluate any new business model.



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¹ King & Spalding Client Alert, *How Far We Haven't Come: SEC Resistance to Blockchain Securities Continues?* (Apr. 11, 2019), <https://www.kslaw.com/news-and-insights/how-far-we-haven-t-come-sec-resistance-to-blockchain-securities-continues>; see also Framework for "Investment Contract" Analysis of Digital Assets, Securities and Exchange Commission, (Apr. 3, 2019), <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>; Statement on Digital Asset Securities Issuance and Trading, Securities and Exchange Commission Division of Corporation Finance, Division of Investment Management, and Division of Trading and Markets (Nov. 16, 2018), <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>.

² FinCEN Guidance, FIN-2019-G001, *Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies* (May 9, 2019) ("May 2019 Guidance" or "Guidance"), <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.

³ Token Taxonomy Act of 2019, H.R. 2144, 116th Cong. (2019); Digital Taxonomy Act of 2019, H.R. 2154, 116th Cong. (2019); see also Joshua Ashley Klayman, "Don't Call It A Comeback: With Two Bills, U.S. Lawmakers Aim To Give New Life to Non-Security Tokens," *Forbes*, (Apr. 13, 2019), <https://www.forbes.com/sites/joshuaklayman/2019/04/13/dont-call-it-a-comeback-with-new-bills-u-s-lawmakers-aim-to-give-new-life-to-non-security-tokens/#2700fbb5900f>.

⁴ May 2019 Guidance at 4; see also 31 CFR § 1010.100(ff)(5)(i)(A) ("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 May 2019 Guidance at 4.

⁶ See Bank Secrecy Act Regulations; Definitions and Other Regulations Relating to Money Services Businesses, 76 Fed. Reg. 43585 (July 21, 2011); FinCEN News Release, *FinCEN Reminds Financial Institutions that the CDD Rule Becomes Effective Today* (May 11, 2018), <https://www.fincen.gov/news-releases/fincen-reminds-financial-institutions-cdd-rule-becomes-effective-today>.

⁷ May 2019 Guidance at 4, 7.

⁸ *Id.* at 7 (emphasis in original).

⁹ One reason for exemption is that the individual or entity is already regulated by the Commodity Futures Trading Commission ("CFTC") or the U.S. Securities and Exchange Commission ("SEC").

¹⁰ May 2019 Guidance at 14-15, 15 n.51.

¹¹ *Id.* at 15.

¹² *Id.* at 15-17.

¹³ *Id.* at 17-18.

¹⁴ *Id.* at 18.

¹⁵ *Id.* at 18-20.

¹⁶ *Id.* at 20-21.

¹⁷ *Id.* at 21-23.

¹⁸ *Id.* at 23.

¹⁹ *Id.* at 23-28.

²⁰ *Id.* at 25.

²¹ *Id.* at 26 (citing FinCEN Guidance, FIN-2008-G008 "Application of the Definition of Money Transmitter to Brokers and Dealers in Currency and other Commodities," (Sept. 10, 2008), <https://www.fincen.gov/sites/default/files/guidance/fin-2008-g008.pdf>).

²² *Id.*



²³ In March 2013, FinCEN released an interpretation directing that exchangers and administrators of virtual currencies are required to register as money services businesses. Ordinary users, however, are excluded. FinCEN Guidance, FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (Mar. 18, 2013), <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>.

²⁴ FinCEN Press Release, *FinCEN Fines Ripple Labs Inc. in First Civil Enforcement Action Against a Virtual Currency Exchanger* (May 5, 2015), https://www.fincen.gov/sites/default/files/shared/Ripple_Facts.pdf.

²⁵ FinCEN Press Release, *FinCEN Fines BTC-e Virtual Currency Exchange \$110 Million for Facilitating Ransomware, Dark Net Drug Sales* (July 27, 2017), <https://www.fincen.gov/news/news-releases/fincen-fines-btc-e-virtual-currency-exchange-110-million-facilitating-ransomware>

²⁶ FinCEN Press Release, *FinCEN Penalizes Peer-to-Peer Virtual Currency Exchanger for Violations of Anti-Money Laundering Laws* (Apr. 19, 2019), <https://www.fincen.gov/news/news-releases/fincen-penalizes-peer-peer-virtual-currency-exchanger-violations-anti-money>.

²⁷ Cyber Enforcement Actions, U.S. Securities and Exchange Commission, <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions> (accessed May 14, 2019), listing more than 20 enforcement actions relating to digital assets and initial coin offerings since July 2017.

²⁸ Omkar Godbole, "Bitcoin's Monthly Price Gains Already Highest Since November 2017," CoinDesk (May 14, 2019), <https://www.coindesk.com/bitcoins-monthly-price-gains-already-highest-since-november-2017> ("Bitcoin (BTC) clocked fresh 10-month highs earlier today and currently appears on track to post its largest monthly gain since late 2017.").