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AML Enforcement in 2023: No 'Grey Zones' for Cryptocurrency Providers

By Matthew Biben and Olivia Radin
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In November 2023, the world's largest cryptocurrency exchange, Binance, agreed to pay $4.3 billion, the largest penalty in U.S. Treasury and FinCEN history, to resolve DOJ, CFTC, FinCEN and OFAC investigations into allegations that it operated as an unregistered money transmitter and willfully violated anti-money laundering ("AML") and sanctions laws. "Binance and CEO Plead Guilty to Federal Charges in $4B Resolution," U.S. Justice Department (Nov. 21, 2023).

Binance's penalty may have been singularly large, but the cryptocurrency exchange was not the only cryptocurrency provider to have faced a significant AML enforcement action in the recent past for allegedly failing to adequately comply with U.S. AML laws.

According to court documents, Binance CEO Changpeng Zhao allegedly encouraged employees to prioritize growth and profits over compliance with U.S. law, telling them that it was "better to ask for forgiveness than permission" in what he allegedly described as operating in the "grey zone." *U.S. v. Changpeng Zhao*, No. 23-cr-00179 (W.D. Wash. Nov. 14, 2023), ECF No. 1 at 4.

The following curated roundup of significant federal and state enforcement actions against cryptocurrency companies in the past several years includes other examples of allegedly "forgiveness-is-better"-minded conduct similar

Matthew Biben, Olivia Radin partners at King & Spalding.

to Binance's. But it also includes seemingly less egregious cases where companies simply failed to maintain adequate AML programs—an enforcement focus that has been consistent over time.

Clearly, a "move fast and break things" ethos creates risk when paired with AML compliance obligations. Recent enforcement history suggests that cryptocurrency companies cannot afford to wait until their business models prove successful to make necessary investments in their AML compliance programs. Or if they do, they will be playing a difficult and risky game of catch up.

If these innovative companies, including those that are foreign-based, plan to operate in the U.S., they would do well to approach compliance with U.S. AML law—especially compliance with the AML provisions of the Bank Secrecy Act ("BSA") —as a key priority from day one. If they fail to do

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so, they run the risk of regulatory scrutiny and punitive treatment that, as the last several years reveal and as evidenced below, is not reserved for traditional financial institutions and may have serious consequences.

BitMEX (August 2021)

In August 2021, BitMEX, a cryptocurrency trading platform for derivatives, settled civil charges with the Commodity Futures Trading Commission (CFTC) and Financial Crimes Enforcement Network (FinCEN) for a total of $100M.

FinCEN alleged that BitMEX conducted transactions involving high-risk jurisdictions while willfully failing to implement an adequate compliance program, conducted at least $209M worth of transactions with "known darknet markets or unregistered money services businesses providing mixing services," and failed to file at least 588 Suspicious Activity Reports (SARs). Press release, "FinCEN Announces $100 Million Enforcement Action Against Unregistered Futures Commission Merchant BitMEX for Willful Violations of the Bank Secrecy Act," FinCEN (Aug. 10, 2021), http://tinyurl.com/4yypyr8y. The CFTC alleged that BitMEX and its founders "conduct[ed] significant aspects of BitMEX's business from the U.S." while unlawfully accepting orders and funds from U.S. customers to trade cryptocurrencies, including derivatives on bitcoin, ether, and Litecoin. Press release, "Federal Court Orders BitMEX to Pay $100 Million for Illegally Operating a Cryptocurrency Trading Platform and Anti-Money Laundering Violations," CFTC (Aug. 10, 2021), http://tinyurl.com/yc6ce9hb.

Of note, leading up to its settlement, and presumably as part of an effort to resolve its AML exposure, FinCEN stated that BitMEX ceased operations and business functions in the United States.

BitMEX also agreed to engage an independent consultant to conduct a historical analysis of its transactions (a so-called "SAR lookback") to determine whether additional SARs were required to be filed. Press release, "FinCEN Announces $100 Million Enforcement Action Against Unregistered Futures Commission Merchant BitMEX," FinCEN. The BitMEX example shows how impactful AML compliance failings can be, both in terms of dollars but also in terms of the impact on the company's ability to operate in the U.S.

Bittrex (October 2022)

In October 2022, the Treasury Department announced what was, at the time, its largest ever virtual currency enforcement action against Washington-based cryptocurrency exchange Bittrex, which entered into settlements for $24M and $29M with OFAC and FinCEN, respectively. Consent Order, *In the Matter of Bittrex, Inc.* (FinCEN Oct. 11, 2022); Enforcement Release, "OFAC Settles with Bittrex, Inc. for $24,280,829.20 Related to Apparent Violations of Multiple Sanctions Programs" (OFAC Oct. 11, 2022).

The allegations against Bittrex describe the exchange as willfully lax in designing and implementing its AML compliance program. At a time when Bittrex was processing tens of thousands of transactions daily totaling millions of dollars, it purportedly had a staff of two employees with allegedly minimal AML training and experience.

In addition, for the majority of the relevant time period, the staff of two employees allegedly conducted a manual review of transactions for suspicious activity and did not use AML software for any aspect of its program. *See* FinCEN Consent Order at 4-7. In violation of its BSA obligations, according to the settlements, Bittrex's alleged failure to develop an effective AML program for years allegedly left its platform vulnerable to abuse by money launderers, terrorist financiers, and sanctions evaders. *See id.* at 1-5.

Coinbase (January 2023)

In January 2023, the New York Department of Financial Services (DFS) entered into a consent order with the cryptocurrency exchange Coinbase for, among other things, alleged violations of the New York Banking Law and DFS regulations on transaction monitoring, virtual currency, and money transmitting, which require compliance with BSA and AML obligations, including reporting and recordkeeping requirements.

As part of its settlement, Coinbase was required to pay a $50M penalty to DFS and devote an additional $50M to remediate issues identified in its compliance program. Consent Order, *In the Matter of Coinbase, Inc.* (N.Y. Dep't of Fin. Servs. Jan. 4, 2023).

According to DFS, Coinbase's growth outpaced the effectiveness of its AML compliance program. As per the consent order, Coinbase was a large and complex exchange but, for years, allegedly had in place only rudimentary know-your-customer procedures and an inadequate BSA/AML program, treating customer onboarding as a "simple check-the-box exercise." *See* "Superintendent Adrienne A. Harris Announces $100 Million Settlement with Coinbase, Inc.," New York State Department of Financial Services press release (Jan. 4, 2023).

The result was that Coinbase allegedly failed to keep pace with its alerts and accumulated a backlog of over 100,000 transaction monitoring alerts that were not reviewed in a timely manner and a backlog of over 14,000 customers requiring enhanced due diligence. As per the consent order, this rendered its platform vulnerable to money laundering and other serious criminal activity. *See* Consent Order, *Coinbase*.

Tornado Cash (August 2023)

In August 2023, Roman Storm and Roman Semenov, the founders and developers of the Tornado Cash service, a cryptocurrency mixer that allegedly allowed its users to engage in transfers of cryptocurrency, were charged with laundering more than $1B in criminal proceeds. The Tornado Cash service was allegedly an open-source software that was posted to a decentralized network.

The indictment against Messrs. Storm and Semenov alleged that they developed the core features of the service, paid for infrastructure to operate it and promoted its services. The Tornado Cash service allegedly advertised to customers that it provided "untraceable and anonymous financial transactions." The indictment alleges that hundreds of millions of dollars were laundered for the Lazarus Group, a sanctioned North Korean organization allegedly engaged in cybercrime.

The indictment further alleges that Tornado Cash's developers received complaints and requests from victims of hacking and cybercrimes, yet continued to facilitate illegal transactions, failed to develop know-your-customer or AML safeguards, and touted what they knew to be ineffective sanctions controls. Of note, the indictment further charges Messrs. Storm and Semenov with operating Tornado Cash as an unregistered money services business ("MSB"). *United States v. Roman Storm and Roman Semenov,* 1:23-cr-00430-KPF (S.D.N.Y. Aug. 21, 2023), ECF No. 1 ¶¶ 1-33, 56-68.

This enforcement action followed sanctions imposed by OFAC against Tornado Cash in August 2022, when OFAC added the cryptocurrency mixer to the specially designated person ("SDN") list. Several Ethereum blockchain users challenged OFAC's designation of Tornado Cash in the Western District of Texas, arguing, among other things, that OFAC exceeded its authority because Tornado Cash is neither a sanctionable "national" nor "person" under the International Emergency Economic Powers Act (IEEPA), the statute under which OFAC designated it as such.

The court upheld the sanctions, finding that Tornado Cash is an entity that can be properly designated as a person under IEEPA. *Van Loon v. U.S. Dep't of Treasury*, 1:23-cv-00312-RP (W.D. Tx. Aug. 17, 2023), ECF 94.

Binance (November 2023)

In November 2023, the U.S. Justice Department unsealed charges against cryptocurrency exchange Binance and Binance CEO Changpeng Zhao for violating the BSA's AML provisions and for causing violations of U.S. sanctions law, among other violations. *U.S. v. Binance Holdings Ltd. d/b/a Binance.com*, No. 23-cr-00178 (W.D. Wash. Nov. 14, 2023); *U.S. v. Changpeng Zhao*, No. 23-cr-00179 (W.D. Wash. Nov. 14, 2023).

In the global resolution of the actions brought against it by the Treasury Department, Justice Department, and CFTC, Binance also agreed in November 2023 to pay over $4B in penalties and to retain an independent compliance monitor for three years as part of its Justice Department settlement and for five years as part of its Treasury Department settlement. *See* Press release, *Binance and CEO Plead Guilty to Federal Charges in $4B Resolution*, U.S. Department of Justice (Nov. 21, 2023); *Binance,* ECF No. 23; Settlement Agreement, U.S. Department of Treasury (Nov. 21, 2023) at 10.

As per the Justice Department's press release, the settlement was the culmination of a federal multiagency effort to resolve allegations that Binance had facilitated billions of dollars in transactions without having in place adequate know-your-customer and transaction monitoring procedures. Binance allegedly facilitated millions of dollars in transactions involving sanctioned jurisdictions including North Korea, Iran, and Russian-occupied regions of Ukraine and processed transactions involving proceeds of various cybercrimes. *Binance*, ECF No. 1 at 1-2.

Bitzlato (December 2023)

In January 2023, the Department of Justice announced charges against Anatoly Legkodymov, the founder of Hong Kong-based cryptocurrency exchange Bitzlato, for allegedly processing more than $700M worth of illicit funds. Press release, "Founder and Majority Owner of Bitzlato, a Cryptocurrency Exchange, Charged with Unlicensed Money Transmitting," U.S. Justice Department (Jan. 18, 2023), http://tinyurl.com/uah99wnp.

In December 2023, Legkodymov pleaded guilty to operating a money transmitting business that allegedly transmitted those illegal funds. Press release, "Founder and Majority Owner of Cryptocurrency Exchange Pleads Guilty to Unlicensed Money Transmitting," U.S. Justice Department (Dec. 6, 2023), https://tinyurl.com/4rcfs6rx.

The government alleged that Bitzlato marketed itself as requiring minimal identification for its users, permitted fraudulent identification information, and provided services to the largest and longest-running darknet market in the world.

In connection with the plea agreement, Legkodymov agreed to dissolve Bitzlato and to release any claim over $23M in assets previously seized. Of note, the Bitzlato operation was led by French and U.S. authorities and supported by Europol, which coordinated efforts to take down the digital infrastructure of the service, which was based in France. *Id.*

Takeaways

Though recent history suggests regulators may treat cryptocurrency exchanges much like traditional banks in AML enforcement actions, the wide-ranging investigation and unprecedented penalties seen in the Binance case suggest that these innovative companies may sometimes face even tougher scrutiny. Press release, "U.S. Treasury Announces Largest Settlements in History with World's Largest Virtual Currency Exchange Binance for Violations of U.S. Anti-Money Laundering and Sanctions Laws," U.S. Treasury Department (Nov. 21, 2023).

Tornado Cash highlights the risk for those operating in this space, as regulators charged the cryptocurrency mixer's founders for developing the software underlying the virtual currency platform, even though they did not formally develop a business organization.

The Tornado Cash indictment shows that organizations and individuals that develop money-transmission or exchange capabilities should be mindful of their obligations under U.S. law.

Finally, as Bitzlato's case demonstrates, it is not just U.S. regulators with an eye on cryptocurrency; successful collaboration between regulators is to be expected.

Indeed, these enforcement actions show that both U.S. and international regulators will pay close attention to the manner in which new businesses incorporate compliance into their business model, particularly when growth is rapid. These enforcement actions show that even where growth does depend on outright flouting of BSA obligations of the sort alleged in Binance's case, growth comes with concomitant obligations under the BSA.

As FinCEN's deputy director suggested over two years ago with regard to BitMEX: "BitMEX's rapid growth into one of the largest futures commission merchants offering convertible virtual currency derivatives without a commensurate anti-money laundering program put the U.S. financial system at meaningful risk." Press release, "FinCEN Announces $100 Million Enforcement Action Against Unregistered Futures Commission Merchant BitMEX," FinCEN (Aug. 10, 2021).

To that end, cryptocurrency providers are taking heed of this message and appropriately changing course. As one example, Tether, a U.S. dollar stablecoin, previously said in August 2022 that it would not freeze Tornado Cash wallet addresses unless required to do so by U.S. regulators, but in early December 2023, Tether announced an "initiative aimed at safeguarding the cryptocurrency system" that included a voluntary wallet-freezing policy aimed at freezing wallets connected with OFAC-sanctioned persons, including those previously designated (which would include Tornado Cash). "Tether Explains Its Decision On Tornado Cash Addresses, Awaits Law Enforcement Instruction," Tether (Aug. 24, 2022), https://tinyurl.com/msw2fbkc; "Tether Introduces New Policy to Strengthen Ecosystem Security," Tether (Dec. 9, 2023), https://tinyurl.com/bdzztetu.

Similarly, the Coinbase settlement is a reminder that even cryptocurrency companies that are committed to, and make investments in, compliance must account for their BSA responsibilities as their business grows. When growth outpaces compliance capabilities, enforcement consequences can follow quickly and severely. It is advisable for exchanges and other financial institutions to remain focused on these risks since they can grow significantly in the space of a few years or less.

Management and boards are well advised to keep AML compliance obligations on their radar and ensure they have appropriate governance structures in place to address these obligations.

Matthew Biben *and* Olivia Radin *are partners in King & Spalding. Senior associate* Kimberly Wade *and law clerk* Jack Leahey *assisted in the preparation of this article.*