



BSA/AML Compliance Issues Relating to Virtual Currency

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Virtual Currency -What is it?

- “Digital currency” / “web-based money transfer system”
- Not tied to a national currency





Key Concepts

- BSA/AML compliance responsibilities attach to institutions (e.g., banks), not products.
- Federal Reserve has no authority to regulate a virtual currency product unless it is issued by, or cleared or settled through, a supervised entity.



Financial Crimes Enforcement Network's Virtual Currency Guidance

March 18, 2013 – FIN-2013-G001

- “Virtual” currency is a medium of exchange that operates like a currency in some environments, but does not have legal tender status in any jurisdiction.
- FinCEN clarified that an *administrator or exchanger* of virtual currency is a money transmitter, a type of money services business.
- Banks maintaining an account for such businesses would apply the same due diligence as with other money transmitters.



FinCEN Guidance Definitions

- Currency is “the coin and paper money of the United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance.”
- “Virtual” currency is a medium of exchange that operates like a currency in some environments, but does not have legal tender status in any jurisdiction.
- Guidance only addresses “convertible” virtual currency





FinCEN Guidance Definitions

- A *user* is a person that obtains virtual currency to purchase goods or services – not covered.
- An *exchanger* is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency.
- An *administrator* is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.



Centralized Virtual Currencies

- The *administrator* of a central virtual currency repository will be a money transmitter to the extent that it allows transfers of value between persons or from one location to another.
- An *exchanger* that uses its access to the convertible virtual currency to accept and transmit the convertible virtual currency on behalf of others, including transfers intended to pay a third party for virtual goods and services, is also a money transmitter.



De-Centralized Virtual Currencies

- A person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is a money transmitter.
- In addition, a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.



Identifying Virtual Currency Accounts/Transactions

- Transactions similar to any other money transmitter.
- Transmittal Orders may contain name of virtual currency, account numbers, and “for purchase of” statements.
- May see high volume/value of transactions to and from 1 major counterparty, along with many low value/volume transfers to or from many different counter-parties.



AML Concerns

- Anonymity, particularly so for virtual currencies that can freely be exchanged for real currency.
- If decentralized, no administrator to maintain information on users and report suspicious activity to governmental authorities.
- Absence clarity regarding the obligations and identity of financial intermediaries to help detect, prevent, and investigate illegal transactions and “follow the money”.
- Lack of traceability may enable circumvention of sanctions.



AML Concerns

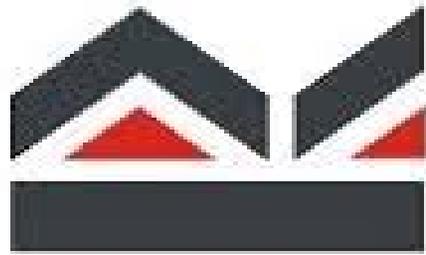
- Difficulty in obtaining customer records:
- While transaction size is limited by the carrying capacity of the virtual currency systems and the exchangers, when taken in the aggregate and given the high velocity of transactions, the relatively small dollar values can quickly add up.
- Investigations into illicit virtual currency businesses often require considerable cooperation from international partners.



Assessing Risk

- As when introducing any new product, financial institutions should ensure their risk assessment is updated to accurately reflect BSA/AML risks associated with a new payment system.
 - Existing or new customers?
 - Online capabilities and non-face to face transactions?
 - Existing or new geographies?
 - 3rd parties?





Liberty Reserve

- In May 2013, U.S. Departments of Justice and Treasury announced actions against Liberty Reserve, including arrests, domain name seizures, accounts seizures, and a Section 311 Notice of Finding and Proposed Imposition of a special measure.



- Liberty Reserve was a centralized administrator of a web-based money transfer system of virtual currency and was used to facilitate money laundering. The DoJ claimed that it “processed an estimated 55 million separate financial transactions and is believed to have laundered more than \$6 billion in criminal proceeds.”
- The FinCEN Section 311 Notice found Liberty Reserve S.A. to be of primary money laundering concern under §311 of USA PATRIOT Act. Treasury proposed the fifth special measure, prohibiting U. S. banks from opening or maintaining foreign correspondent accounts for on behalf of Liberty Reserve.



Mt. Gox

- On Tuesday, May 14, 2013, the U.S. account of Mt. Gox, the largest Bitcoin Exchanger, at the payment processor Dwolla was seized by DHS, because their U.S. subsidiary, Mutum Sigillum, failed to register as a MSB money transmitter for transferring money from U.S. citizens to Mt. Gox for buying and selling the Bitcoins.
- Mt. Gox shut down in February of 2014 and filed for bankruptcy after it was revealed that around \$450 million worth of Bitcoins had been stolen.



Silk Road

anonymous marketplace

Shop by category:

Cannabis(162)
Ecstasy(33)
Psychedelics(119)
Opioids(33)
Stimulants(56)
Dissociatives(6)
Other(199)



1 hit of LSD
(blotter)
\$1.13



1/8 oz high
quality cannabis
\$3.17

- On October 2, 2013, the FBI shut down underground website Silk Road, an online market.
- Silk Road operated as a Tor hidden service, such that online users are supposedly able to browse it anonymously and securely without potential traffic monitoring. The website launched in February 2011. Silk Road is sometimes called the "Amazon.com of illegal drugs" or the "eBay for drugs," though it also sells other categories of merchandise.
- Ross William Ulbricht, the alleged founder and chief operator who went by the name "Dread Pirate Roberts," was arrested on charges of murder-for-hire and narcotics trafficking in addition to money laundering.
- On 6 November 2013 it was reported that Silk Road 2.0 was online and being run by former administrators of Silk Road and that a different user was now using the name, Dread Pirate Roberts.



IRS Treats Bitcoin as Property



- IRS Notice 2014-21 (March 25 2014) states that convertible virtual currencies, such as Bitcoin, are considered “property,” therefore capital gains must be recorded and reported. Owners of such virtual currencies are responsible for recording the market price in USD of their virtual currency the day they are obtained, then report the difference in the market price the day the virtual currency is used or sold. The gain is considered capital gains and is taxed.



NY DFS Announces Regulations for Bitcoin Exchanges

- On March 11, 2014, the New York State Department of Financial Services issued an order which allowed firms to submit proposals for setting up an exchange in New York. Regulators would then work with those companies to make sure the exchanges adhered to cybersecurity and anti-money laundering rules.
- DFS stated that this would be the start of a regulatory process to create an official framework for virtual-currency companies in New York state to be proposed “no later than the end of the second quarter of 2014.” DFS also stated it is continuing work on a “BitLicense,” or a specific set of regulations for virtual currency companies.
- U.S. lacks a Bitcoin exchange, a market for trading Bitcoins for dollars and vice versa. Besides the now bankrupt Japanese exchange Mt. Gox, the other two Bitcoin exchanges are based in Slovenia and Bulgaria.