

Banking Cryptocurrency: BSA and Other Compliance Considerations

June 13, 2019

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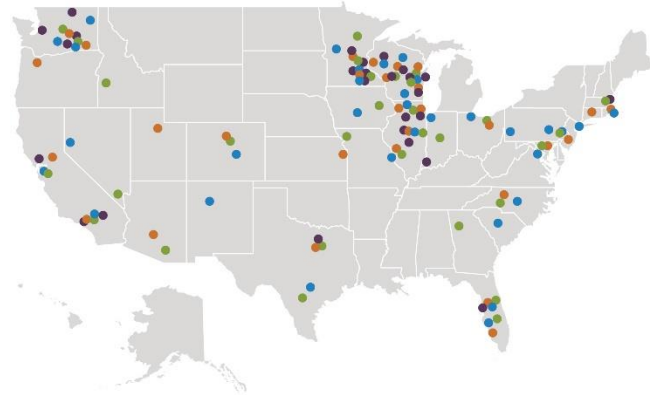
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Speaker Introduction

- Matt Hagen is a regulatory compliance consultant in CLA's financial institutions practice. He focuses on providing regulatory compliance consulting for financial institutions through a combination of on-site visits and remote work. Matthew works with our clients to assist them in establishing and improving compliance programs including conducting targeted compliance assessments, staff training on financial institution regulations, and BSA/AML/OFAC independent testing.



Topics

- What are digital/crypto/virtual currencies?
- Different types of cryptocurrency consumers.
- Cryptocurrency and banking.
- Compliance considerations.
- Cryptocurrency developments.



What are Cryptocurrencies?

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Digital Gold

- Digital currency
- Medium of exchange
- Limited entries on a database
- Restrictions on change
- Decentralized











History

- September 1996 – Alan Greenspan

“We could envisage proposals in the near future for issuers of electronic payment obligations, such as stored-value cards or “digital cash,” to set up specialized issuing corporations with strong balance sheets and public credit ratings.”



Top 10 Cryptocurrencies

Cryptocurrencies ▾ Exchanges ▾ Watchlist						
#	Name	Symbol	Market Cap	Price	Circulating Supply	Volume (24h)
1	 Bitcoin	BTC	\$94,185,388,617	\$5,333.37	17,659,637	\$13,859,462,585
2	 Ethereum	ETH	\$18,096,466,299	\$171.10	105,766,127	\$5,766,224,748
3	 XRP	XRP	\$13,558,168,014	\$0.323039	41,970,748,057 *	\$1,014,800,255
4	 Bitcoin Cash	BCH	\$5,156,741,854	\$290.65	17,742,400	\$1,139,405,313
5	 EOS	EOS	\$4,943,228,019	\$5.24	942,708,207 *	\$1,805,781,771
6	 Litecoin	LTC	\$4,707,527,238	\$76.60	61,452,959	\$2,590,809,051
7	 Binance Coin	BNB	\$3,453,840,950	\$24.46	141,175,490 *	\$236,882,274
8	 Tether	USDT	\$2,613,502,656	\$1.01	2,595,804,411 *	\$11,450,972,933
9	 Stellar	XLM	\$2,189,778,326	\$0.113087	19,363,613,344 *	\$234,161,561
10	 Cardano	ADA	\$1,956,123,843	\$0.075447	25,927,070,538	\$78,107,461

Source: www.coinmarketcap.com accessed on April 22, 2019

History – Bitcoin

- 2008 Whitepaper
- Santoshi Nakamoto
- Outside of government control
- Outside of traditional banking
- “A digital version of gold”
- Spent anywhere, by anyone, with no “trusted third-party”

How it Works

- Peer-to-peer (P2P) network
- Sharing and logging transactions
- Open Source

How it Works – Bitcoin

- The Blockchain – a public ledger
- Two participants
 - Users: initiate transactions
 - Miners: validate transactions
- Public and private keys
- Redundant versions across P2P network



How it Works – Bitcoin

- Users
 - Individuals, companies, even devices
 - Two types:
 - ◇ Transactors
 - Purchase goods or services
 - P2P Transactions
 - ◇ Investors
 - Speculative purposes
 - Similar to traditional investors in stocks or commodities

How it Works – Bitcoin

- Miners
 - Individuals or entities who validate transactions
 - This is how new bitcoins are created and earned
 - Transactions are collected and turned into a list
 - Create a “hash” – random sequence of numbers and letters
 - Hash is added to the blockchain



How it Works – Summary

- A digital ledger of transactions,
- Secured by cryptographic codes,
- That acts as a decentralized currency,
- Which can be exchanged between peers by sharing public passwords that relate back to digital wallets.



Other Market Participants






- Wallet Providers
 - Digital options for storage of public and private keys
 - Cloud-based
 - Software-based
 - Hardware

Other Market Participants

- Exchanges
 - Transfer of cryptocurrency to fiat currency
 - Transfer of cryptocurrency to cryptocurrency
 - Often linked to bank accounts at traditional financial institutions



Top 5 Crypto Exchanges

Cryptocurrencies ▾		Exchanges ▾		Watchlist	
#	Name	Adj. Vol (24h)*	Volume (24h)	Volume (7d)	Volume (30d)
1	 HitBTC	\$885,538,126	\$885,538,126	\$4,998,541,464	\$27,883,671,756
2	 OKEx	\$872,113,876	\$872,113,876	\$5,967,206,593	\$37,211,837,619
3	 DigiFinex	\$845,833,220	\$845,833,220	\$5,602,638,376	\$34,822,006,886
4	 Coineal	\$840,980,948	\$840,980,948	\$5,071,594,099	\$27,496,788,623
5	 BitForex	\$815,887,941	\$815,887,941	\$4,802,782,598	\$26,871,795,187

Source: www.coinmarketcap.com accessed on April 22, 2019



Other Market Participants

- ATM manufactures and operators
 - Withdraw cryptocurrency
 - Convert cryptocurrency to fiat currency
 - Maintain an inventory of both cryptocurrency and fiat currency



Other Market Participants

- Payment processors
 - Enable businesses to accept cryptocurrency
 - Cryptocurrency or fiat currency



Cryptocurrency and Banking

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FinCEN

- March 18, 2013 – FIN-2013-G001
 - Application of FinCEN's regulations to persons administering, exchanging, or using virtual currencies
 - Definitions:
 - ◇ User
 - ◇ Exchanger
 - ◇ Administrator

FinCEN – FIN-2013-G001

- User
 - A person who obtains virtual currency to purchase goods or services.
- Exchanger
 - A person who is engaged in the business of exchanging virtual currency for fiat currency, other funds, or other virtual currency.



FinCEN – FIN-2013-G001

- Administrator
 - A person engaged in the business of issuing a virtual currency and has the authority to redeem the virtual currency.

FinCEN – FIN-2013-G001

- Money Service Businesses (MSBs)
 - Exchangers and administrators that:
 1. Accept and transmits a convertible cryptocurrency, or
 2. Buys or sells convertible cryptocurrency for any reason as a money transmitter.
- Users – Specifically designated as non-MSBs



FinCEN Applicability

Bitcoin Participant	Applicable FinCEN Definition	MSB Registration Status
Users	User	Not Required
Miners	User	Not Required ^D
Wallet Providers ^E	N/A	Not Required
Exchanges	Exchanger	Required
ATM Manufacturers	N/A	Not Required
ATM Operators	Exchanger	Required
Payment Processors	Exchanger	Required

^D This assumes that the miner uses mined bitcoins for its own purpose and not for the benefit of any other entity. However, a user wishing to purchase goods or services with bitcoin it has mined, which pays the bitcoin to a third party at the direction of a seller or creditor, may be engaged in money transmission and required to register as an MSB.

^E FinCEN has not issued an administrative ruling specific to wallet providers. Wallet providers can simply provide a user with the means to maintain bitcoins. Alternatively, wallet providers can enable additional functionality that ultimately allows for the transmission of real currency for virtual currency, with the potential to be considered an exchange.

Source: Banking Bitcoin-Related Businesses: A Primer for Managing BSA/AML Risk, October 2015 – Revised February 2016
(https://www.frbatlanta.org/-/media/documents/rprf/rprf_pubs/2016/banking-bitcoin-related-businesses.pdf)



FinCEN – FIN-2014-R011

- VC platform
- Virtual currency exchange platform
- Declares a money transmitter
- Matching orders from buyers and sellers
- No exemption for either:
 - Money transmission integral to the sale of a good or service
 - Payment processor



FinCEN – FIN-2014-R012

- Accept credit card payments from customers and transferring Bitcoin to merchant
- FinCEN concluded that it is a money transmitter
- Neither MSB exception applies



FinCEN – FIN-2014-R011/R012

- The exemption for money transmission integral to the sale of a good or service is available only if the party seeking the exemption is itself the seller.
- The payment processor exemption is applicable only where the entity is acting *entirely* within a clearance and settlement system consisting of FinCEN-regulated financial institutions.



FinCEN

- February 2018 – Letter to U.S. Senate Committee on Finance
 - Initial Coin Offerings (ICOs)
 - Securities and Exchange Commission (SEC)
 - AML/CFT requirements

FinCEN – FIN-2019-G001

- May 9, 2019
- Interpretive guidance on how MSB requirements apply to convertible virtual currencies (CVCs).
- *“Does not establish any new regulatory expectations or requirements.”*



FinCEN – FIN-2019-G001

- “[T]ransactions denominated in CVC will be subject to FinCEN regulations regardless of whether the CVC is represented by a physical or digital token, whether the type of ledger used to record the transaction is centralized or distributed, or the type of technology utilized for the transmission of value.”



FinCEN – FIN-2019-G001

- P2P Exchangers
 - *“A natural person operating as a P2P exchanger that engages in money transmission services involving real currency or CVCs must comply with BSA regulations as a money transmitter acting as principal... However, a natural person engaging in such activity on an infrequent basis and not for profit or gain would be exempt from the scope of money transmission.”*

FinCEN – Non-Bank Financial Institutions

- Requirements for the MSB
 - FinCEN requires that MSBs register with the Department of the Treasury and renew their registration every two years.
 - MSBs must also maintain a list of their agents and update the list annually.
 - Comply with state government registration and/or licensing requirements as applicable.
 - Name a Bank Secrecy Act (BSA) Officer.



FinCEN – Non-Bank Financial Institutions

- Requirements for the MSB continued
 - Develop a written BSA/AML policy
 - Conduct a risk assessment and take steps to mitigate or manage risks.
 - Conduct regular training for employees regarding BSA/AML requirements.
 - Engage an independent audit function to test programs.



Unique Know Your Customer Challenges

- Exchangers and wallet providers
 - Electronic-only environment
 - Outsourcing
- ATM operators
 - Physical ATMs
- Payment processors
 - Underwriting merchant accounts
 - Merchant motivation for accepting cryptocurrency





Compliance Considerations

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The Basic's

- Field of membership/customer base
- BSA policy
 - Can you have an MSB and/or Private ATM operator as a consumer?
 - If necessary:
 - ◇ Update BSA policy
 - ◇ Obtain board of directors approval
 - ◇ Develop and implement MSB/private ATM procedures
 - ◇ Update BSA/AML risk assessment
 - ◇ Update OFAC risk assessment

Documentation

- Write it down!

FFIEC BSA/AML Interagency Exam Manual – Money Service Businesses

- Not the MSBs *de facto* regulator
- Not held responsible for the MSBs BSA/AML program
- Different risk = different due diligence



FFIEC Exam Manual – MSBs

- Minimum Due Diligence
 - Applying the financial institutions CIP/MIP;
 - ◇ Including Beneficial Ownership Prong, as applicable
 - Confirming FinCEN registration;
 - Compliance with state and local licensing/registration requirements;
 - Confirmation of agent status, and;
 - Conduct a BSA/AML risk assessment.



FFIEC Exam Manual – MSBs

- Risk Assessment
 - Consider:
 - ◇ Purpose of the account
 - ◇ Anticipated account activity
 - Type
 - Volume
 - ◇ Products and services offered by the MSB
 - ◇ Location and market served by the MSB



FFIEC Exam Manual – MSBs

- Risk Assessment
 - Tailored to membership base or geographic area served.
 - Heightened risk of money laundering or terrorist financing triggers enhanced due diligence.



FFIEC Exam Manual – MSBs

- Increased Risks with MSBs
 - Lack ongoing customer relationships and require minimal or no identification from customers.
 - Maintain limited or inconsistent recordkeeping on customers and transactions.



FFIEC Exam Manual – MSBs

- Increased Risks with MSBs
 - Engage in frequent currency transactions.
 - Are subject to varying levels of regulatory requirements and oversight.
 - Can quickly change their product mix or location and quickly enter or exit an operation.
 - Sometimes operate without proper registration or licensing.

FFIEC Exam Manual – MSBs

- Risk Mitigation
 - Risk Mitigation Factors
 - ◇ Review of required MSB items
 - ◇ Consideration of banking relationships
 - ◇ Operating history
 - ◇ Service area
 - ◇ Domestic/international activity
 - ◇ Expected transaction activity



FFIEC Exam Manual – MSBs

- Enhanced Due Diligence
 - Review the MSB's BSA/AML program.
 - Review results of the MSB's independent testing of its AML program.
 - Review written procedures for the operation of the MSB.
 - Conduct on-site visits.



FFIEC Exam Manual – MSBs

- Enhanced Due Diligence
 - Review list of agents, including locations, within or outside the United States, which will be receiving services directly or indirectly through the MSB account.
 - Determine whether the MSB has performed due diligence on any third-party servicers or paying agents.



FFIEC Exam Manual – MSBs

- Enhanced Due Diligence
 - Review written agent management and termination practices for the MSB.
 - Review written employee screening practices for the MSB.



FFIEC Exam Manual – Privately Owned ATMs

- Particularly susceptible to money laundering and fraud
- Independent Sales Organizations (ISO) relationships
- Additional risk factors
 - Registration
 - Ownership
 - Monitoring
 - Examination



FFIEC Exam Manual – Privately Owned ATMs

- Risk Mitigation
 - Appropriate risk-based due diligence on the ISO, through a review of corporate documentation, licenses, permits, contracts, or references.
 - Review of public databases to identify potential problems or concerns with the ISO or principal owners.



FFIEC Exam Manual – Privately Owned ATMs

- Risk Mitigation
 - Understanding the ISO's controls for currency servicing arrangements for privately owned ATMs, including source of replenishment currency.
 - Documentation of the locations of privately owned ATMs and determination of the ISO's target geographic market.
 - Expected account activity, including currency withdrawals.



FFIEC Exam Manual – Privately Owned ATMs

- Enhanced Due Diligence
 - Reviewing corporate documentation, licenses, permits, contracts, or references, including the ATM transaction provider contract.
 - Reviewing public databases for information on the ATM owners.



FFIEC Exam Manual – Privately Owned ATMs

- Enhanced Due Diligence
 - Obtaining the addresses of all ATM locations, ascertaining the types of businesses in which the ATMs are located, and identifying targeted demographics.
 - Determining expected ATM activity levels, including currency withdrawals.



FFIEC Exam Manual – Privately Owned ATMs

- Enhanced Due Diligence
 - Ascertaining the sources of currency for the ATMs by reviewing copies of armored car contracts, lending arrangements, or any other documentation, as appropriate.



FFIEC Exam Manual – Privately Owned ATMs

- Enhanced Due Diligence
 - Obtaining information from the ISO regarding due diligence on its sub-ISO arrangements, such as the number and location of the ATMs, transaction volume, dollar volume, and source of replenishment currency.





News and Updates

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Ripple Labs Inc.

- FinCEN and U.S. District Attorney for the Northern District of California – May 5, 2015
- \$700,000 civil money penalty
- Ripple Labs Inc. and XRP II, LLC
- Issues
 - Acting as an unregistered MSB
 - Failing to implement and maintain an AML program
 - Failing to report suspicious activity

Ripple Labs Inc.

- FinCEN Director Calvery

“Virtual currency exchangers must bring products to market that comply with our anti-money laundering laws... Innovation is laudable but only as long as it does not unreasonably expose our financial system to tech-smart criminals eager to abuse the latest and most complex products.”

BTC-e – Virtual Currency Exchange

- FinCEN – July 27, 2017
- \$110,003,314 civil money penalty
- Internet-based, foreign-located money transmitter

BTC-e – Virtual Currency Exchange

- Issues
 - Willful violations of U.S. AML laws
 - Failing to obtain CIP/MIP information
 - Facilitating illegal transactions
 - Processing transactions involving stolen funds



BTC-e – Virtual Currency Exchange

- Acting FinCEN Director Jamal El-Hindi

“We will hold accountable foreign-located money transmitters, including virtual currency exchangers, that do business in the United States when they willfully violate U.S. anti-money laundering laws. . . Treasury’s FinCEN team and our law enforcement partners will work with foreign counterparts across the globe to appropriately oversee virtual currency exchangers and administrators who attempt to subvert U.S. law and avoid complying with U.S. AML safeguards.”



Eric Powers – P2P Exchanger

- FinCEN – April 18, 2019
- P2P exchanger of virtual currency
- \$35,000 fine
- Barred from providing MSB services



Eric Powers – P2P Exchanger

- Issues
 - Failed to register as a MSB
 - No written BSA policies or procedures
 - Failed to report suspicious activity
 - Failed to report currency transactions



Eric Powers – P2P Exchanger

- FinCEN Director Kenneth A. Blanco

“Obligations under the BSA apply to money transmitters regardless of their size. . . It should not come as a surprise that we will take enforcement action based on what we have publicly stated since our March 2013 Guidance—that exchangers of convertible virtual currency, such as Mr. Powers, are money transmitters and must register as MSBs.”



QuadrigaCX

- Canadian Bitcoin Exchange
- CEO Gerald Cotton – deceased
- Encrypted Wallets – locked with password
- \$200,000,000 in customer funds



Questions?

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Thank you!

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