CLIENT ALERT

FinCEN's Action Against BTC-e: Another Effort to Bring Law and Order to the Virtual Currency Frontier

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On July 26, 2017, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) assessed a civil money penalty of more than $110 million against BTC-e, a Russian-headquarted, internet-based virtual currency exchanger, and a $12 million penalty against its Russian owner, Alexander Vinnik. On that same day, the Department of Justice announced a 21-count indictment against Vinnik for money laundering and the operation of an unlicensed money services business (MSB). Vinnik was arrested in Greece the day before. This is the second time FinCEN has pursued enforcement against a virtual currency provider. It also represents the second largest penalty FinCEN ever has levied against an MSB.

Virtual currencies, which entered into mainstream consciousness with the advent of Bitcoin and its progeny, do not have legal tender status in any jurisdictions. However, "convertible" virtual currencies have equivalent value in real currency or act as a substitute for real currency, while often allowing users a greater degree of anonymity than real currency. BTC-e exchanged U.S. dollars, Russian Rubles, and Euros for virtual currencies Bitcoin, Litecoin, Namecoin, Novacoin, Peercoin, Ethereum, and Dash.

FinCEN has authority under the Bank Secrecy Act (BSA) to regulate MSBs, including money transmitters. In March 2013, FinCEN issued interpretative guidance identifying "exchangers" of virtual currency – defined as persons engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency – as money transmitters subject to regulation as MSBs under the BSA. The assessment against BTC-e alleges failure to register with FinCEN as an MSB as well as gross failures to maintain appropriate anti-money laundering (AML) controls and to report suspicious transactions as required by the BSA.

FinCEN's previous enforcement action was for $700,000 for similar violations against popular virtual currency provider Ripple Labs, in 2015. The substantial difference in penalties between the two may be attributable in part to the facts that: (1) Ripple's penalty was a negotiated settlement, as part of broader non-prosecution agreement with DOJ, whereas the assessment against BTC-e is nonconsensual; (2) BTC-e customers allegedly openly discussed their use of the exchanger to facilitate the sale of drugs and other unlawful activity without objection or further diligence from BTC-e; (3) BTC-e's customer base allegedly consisted largely of "criminals who desired to conceal proceeds from crimes such as ransomware, fraud, identity theft, tax refund fraud schemes, public corruption, and drug trafficking"; and (4) BTC-e allegedly failed to demand or verify even basic identifying information for its customers and allowed the use of tools, such as bitcoin "mixers," that obscured the identity of transacting parties.

Although not technically a penalty action, in June 2013 FinCEN also used Section 311 of the USA PATRIOT Act to identify another foreign virtual currency provider closely linked to criminal activity, Liberty Reserve S.A., as a 'primary money laundering concern' under Section 311 of the USA PATRIOT Act, and to propose special measures that would have cut off the company's access to U.S. correspondent banking, once again in coordination with arrests and prosecution by DOJ.

FinCEN clarified by rule in 2011 that MSBs conducting business wholly or in substantial part in the United States are subject to regulation under the BSA for such activities, even if the MSBs have no physical presence there. FinCEN's assessment against BTC-

e appears to represent the first time FinCEN has taken action under this guidance against a foreign MSB with no physical presence in the U.S.

Practical Considerations

These actions, along with FinCEN's 2013 guidance, and numerous administrative rulings since then about whether various virtual currency models qualify as MSB activity, offer several lessons. First, FinCEN appears determined to bring "legitimate" virtual currency providers under its regulation while taking strong steps to punish providers that wilfully allow the use of their systems to facilitate illegal activity, including through measures that preserve the anonymity of transacting parties. Second, FinCEN is willing to target foreign virtual currency businesses that lack any physical presence in the U.S., so long as they do substantial business there. This may occur either through civil enforcement actions or through the use of other tools such as Section 311. Third, FinCEN's enforcement actions and various administrative rulings since its 2013 guidance suggest that determining whether a virtual currency activity is subject to regulation by FinCEN can be difficult. For example, FinCEN has issued rulings clarifying that a party renting computer systems to mine virtual currency would not be a money transmitter, but that a party that proposed to accept credit card payments on behalf of merchants and then to pay the merchants in virtual currency would be. For all of these reasons, U.S. and foreign entities considering providing virtual currency-related services should consult available FinCEN guidance and consider carefully whether their business models may qualify as MSB activity. They should use counsel as appropriate to assist them in navigating this emerging area of the law, and should consider seeking an administrative ruling from FinCEN in close cases.

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